86-88

No. ——



IN THE

# Supreme Court of the United States

OCTOBER TERM, 1986

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CITICORP INDUSTRIAL CREDIT, INC.,
*Petitioner,*

v.

WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
*Respondent.*

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**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT**

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## QUESTION PRESENTED

In conflict with the holdings of two other courts of appeals, the Sixth Circuit held that the "hot goods" provision of the Fair Labor Standards Act (29 U.S.C. § 215 (a)(1)) prohibits a secured creditor from selling inventory collateral unless the creditor pays the wages due its insolvent debtor's employees. The question presented is:

Whether, in enacting the Fair Labor Standards Act, Congress intended not only to establish minimum wage rates, but also to displace the rights of bona fide purchasers and lienholders established by state and other federal law.

## LIST OF PARTIES

In addition to the parties identified in the caption of the case, Ely Group, Inc. and two entities identified as Ely Group subsidiaries, Rockford Textile Mills, Inc. and Ely & Walker, Inc., were named defendants in the Secretary's complaints. Neither Ely Group nor any Ely Group subsidiary participated in the proceedings below.*

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* Petitioner Citicorp Industrial Credit, Inc. is a wholly-owned subsidiary of Citicorp Banking Corporation, which is a wholly-owned subsidiary of Citicorp, a publicly-held corporation. Rule 28.1, Rules of the Supreme Court of the United States.

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Citicorp Industrial Credit, Inc., through its counsel, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in these cases.

### OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-16a) is reported at 788 F.2d 1200. The opinions of the district courts (App., *infra*, 18a-33a) are reported at 608 F. Supp. 215 (E.D. Tenn.), and 621 F. Supp. 22 (W.D. Tenn.).

### JURISDICTION

The judgment of the court of appeals (App., *infra*, 17a) was entered on April 23, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## STATUTORY PROVISIONS INVOLVED

Section 15(a)(1) of the Fair Labor Standards Act (29 U.S.C. § 215(a)(1)) provides:

(a) After the expiration of one hundred and twenty days from June 25, 1938, it shall be unlawful for any person—

(1) to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 206 or section 207 of this title, or in violation of any regulation or order of the Administrator issued under section 214 of this title; except that no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful;

Sections 6 and 7 of the Fair Labor Standards Act (29 U.S.C. §§ 206, 207), which prescribe minimum regular wage rates and overtime wage rates for covered employees, are reproduced in the appendix to this petition. App., *infra*, 36a-56a.

## STATEMENT OF THE CASE

The Sixth Circuit has held that the Fair Labor Standards Act of 1938 ("FSLA") requires a commercial lender to pay the wages of its insolvent debtor's employees or



forfeit the value of inventory pledged as collateral to secure cash advances. In the nearly 50 years since the FLSA was enacted, no other court of appeals has interpreted the statute to require such a result—a result far removed from the manifest purpose of the Act to establish decent wages and hours for American workers. To reach this extraordinary conclusion, the Sixth Circuit explicitly rejected the holdings of both the Second Circuit and the Fourth Circuit. Furthermore, contrary to this Court's repeated admonitions, the Sixth Circuit's construction of the FLSA unnecessarily creates tension with the intended operation of other federal statutes, and displaces state law.

1. Ely Group, Inc. is a defunct manufacturer of hosiery and clothing. In December, 1983, petitioner Citicorp Industrial Credit, Inc. ("Citicorp") and Ely entered into a standard commercial financing agreement. C.A. App. 343-411; see *id.*, 340-342.[1] Ely granted Citicorp a security interest in its accounts receivable and inventory to secure repayment of loans to be made by Citicorp under the agreement. C.A. App. 356-357.[2] Citicorp perfected its security interest in accordance with applicable state law by filing a financing statement with appropriate state officials. App., *infra*, 2a, 19a-20a; C.A. App. 33, 44, 75, 418.

Ely defaulted on its obligations under the financing agreement, and on February 11, 1985, Citicorp notified Ely that no additional funds would be advanced. C.A. App. 412-413. Citicorp was then entitled to take possession of its collateral, including Ely's inventory. At the request of Ely's management, however, Citicorp refrained from exercising its right to take possession of the inventory,

[1] "C.A. App." refers to the joint appendix filed in the court of appeals. When the financing agreement was executed, Ely Group was known as Qualitex Corporation. App., *infra*, 2a.

[2] Under the agreement, payments from Ely's customers were deposited in a Citicorp account, and applied against the advances made by Citicorp. C.A. App. 189-190, 208-209, 321-322.

in order to give Ely an opportunity to devise a plan to continue operating and to pursue alternative sources of financing. C.A. App. 301-302.

Approximately one week later, on February 19, 1985, Ely ceased operations, and Citicorp took possession of its inventory collateral. App., *infra*, 3a. Ely had failed to pay its employees for work performed between February 3 and February 19, 1985. App., *infra*, 27a, 29a-30a.[3] In accordance with the terms of the financing agreement and applicable state law, Citicorp proposed to collect Ely's receivables, liquidate Ely's inventory, and apply the proceeds to the outstanding Ely loan balance of approximately $9.5 million. See App., *infra*, 3a.

2. In March, 1985 respondent Secretary of Labor filed two suits under §§ 15, 16, and 17 of the Fair Labor Standards Act (29 U.S.C. §§ 215, 216, 217) against Citicorp and Ely in the United States District Courts for the Eastern District of Tennessee and the Western District of Tennessee.[4] In both actions, the Secretary sought injunctive relief, and unpaid wages and liquidated damages on behalf of Ely employees. C.A. App. 4-7 (E.D. Tenn.), 110-114 (W.D. Tenn.).

Sections 6 and 7 of the FLSA prescribe minimum regular wage and overtime wage rates for covered employees. 29 U.S.C. §§ 206, 207, App., *infra*, 36a-56a. Section 15(a)(1), one of several mechanisms Congress adopted to induce employers to comply with these substantive provisions of the Act, makes it unlawful for "any person"

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[3] Some Ely payroll checks issued on February 8 were dishonored for insufficient funds; no payroll checks were issued after that date. C.A. App. 120, 281.

[4] *Donovan* v. *Rockford Textile Mills, Inc., Ely Group, Inc., and Citicorp Industrial Credit, Inc.*, Civ. Action No. 4-85-26 (E.D. Tenn.) (complaint filed March 15, 1985); *Ford* v. *Ely Group, Inc., Rockford Textile Mills, Inc., Ely & Walker, Inc., and Citicorp Industrial Credit, Inc.*, Civ. Action No. 85-2276H (W.D. Tenn.) (complaint filed March 21, 1985).



to transport, sell, or ship in commerce goods produced by employees not paid the prescribed minimum wages.

It is undisputed that Ely's wage rates satisfied the requirements of §§ 6 and 7 of the FLSA. C.A. App. 34; see App., *infra*, 13a. There is no evidence of wrongdoing by Citicorp, or of any participation by Citicorp in Ely management's decisions concerning the use of funds to pay employees or other creditors. App., *infra*, 25a-26a, 32a; see App., *infra*, 10a. The Secretary's theory is that an insolvent employer's failure to pay his employees, in breach of their respective employment contracts, violates the minimum wage and overtime provisions of the FLSA. On the basis of that asserted violation of §§ 6 and 7 by Ely, the Secretary invoked § 15(a)(1) against Citicorp, arguing that because § 15(a)(1) makes it unlawful for "any person" to sell goods produced in violation of the Act, Congress intended it to apply to secured creditors who have nothing to do with either the establishment or the payment of employee wages. According to the Secretary, therefore, when a creditor takes possession of "tainted" goods pursuant to a valid security agreement, the creditor may sell the collateral only if its debtor's employees are first paid.

Both district courts accepted the Secretary's theory, and enjoined Citicorp from selling any Ely inventory produced during the period for which Ely employees had not been fully paid.[5] Over the opposition of the Secretary, the district court judgments were stayed pending appeal. Citicorp was permitted to sell the inventory on condition that it hold the proceeds of all sales in a separate account and agree to pay the statutorily required wages due Ely employees if § 15(a)(1) were held applicable.[6]

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[5] *See* page 4, note 3, *supra*; C.A. App. 79-80, 427.

[6] App., *infra*, 4a; C.A. App. 104-105, 432-433; *see* App., *infra*, 10a n.9 ("Citicorp . . . removed the 'taint' from the goods by

3. The cases were consolidated for briefing and oral argument in the United States Court of Appeals for the Sixth Circuit. In affirming the district court judgments, the court of appeals explicitly rejected the holdings of the Second Circuit in *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730 (2d Cir. 1966), and the Fourth Circuit in *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971), both of which held § 15(a)(1) inapplicable to secured creditors that had foreclosed on goods produced by their debtors in violation of the FLSA. App., *infra*, 7a-8a. The court of appeals recognized that "Congress never directly considered the question whether the 'hot goods' provision [29 U.S.C. § 215(a)(1)] applies to secured creditors." App., *infra*, 12a. Nonetheless, relying on the general language of § 15 and its view that enforcing § 15(a)(1) against a secured creditor that had nothing to do with employee wages would further Congress' purpose to protect business from competition from goods produced under substandard labor conditions, the majority held that Citicorp was subject to injunction under § 15. App., *infra*, 4a-7a.[7]

Judge Engel dissented, arguing that after twenty years of settled law in this area, the court should follow the controlling construction of the FLSA adopted by the courts of appeals for the Second Circuit and the Fourth Circuit, absent compelling reason for rejecting that view. Given the length of time the rule established in *Powell*

agreeing to pay the statutorily required wages if . . . 29 U.S.C. § 215(a)(1) applies to secured creditors"). Subsequently, the conditions of the stay were modified to allow Citicorp to reduce the amount of money held separate for payment of Ely employee-wage claims to $1.5 million. App., *infra*, 34a-35a.

[7] By permitting Citicorp to sell the inventory on condition that it agree to pay the Ely employees' unpaid, statutorily required wages if § 15(a)(1) were held applicable, the court of appeals implicitly rejected any suggestion that the inventory was either inherently or permanently "tainted" contraband.



*Knitting* had governed and the nature of the commercial practices that would be affected, Judge Engel emphasized the obvious "need for a uniform national construction of the Act . . . ." App., *infra*, 15a.

Judge Engel explained that the majority's holding effectively "create[d] a judicial lien superior to the otherwise lawful lien which Citicorp possessed in the goods." App., *infra*, 15a.[8] In Judge Engel's view, the Secretary's only "motivation" for invoking § 15 against a secured creditor of a financially distressed employer was to pressure the creditor to pay the wages of its debtor's employees. App., *infra*, 15a.[9] As the majority conceded, there was no evidence Congress intended § 15 to apply to a secured creditor. Accordingly, Judge Engel concluded that Congress intended to permit the claims of employees of insolvent corporations to be governed by "traditional sources of law," namely, "[s]tate laws governing creditors' rights, state laws protecting employees from non-payment of wages and bankruptcy laws generally." App., *infra*, 15a. Moreover, Judge Engel argued, the minimum wage provisions of the Fair Labor Standards Act were never intended to apply to an insolvent employer, unable to pay any wages at all. App., *infra*, 13a.

## REASONS FOR GRANTING THE PETITION

The holding of the court of appeals admittedly conflicts with the well-settled construction of § 15 of the Fair Labor Standards Act adopted by both the Second Circuit and the Fourth Circuit. The question presented is important to both government and private secured lenders throughout the country. The court of appeals has estab-

[8] *See also* C.A. App. 57 (counsel for the Secretary noted "[w]e're saying employees have priority").

[9] In the district court, the Secretary was explicit. Although an injunction entered under § 15(a)(1) would not "order any payment by anyone," it "puts pressure on either party [*i.e.*, the employer and the secured creditor] to arrange for payment [of employees' wages]." C.A. App. 42-43; *see also* C.A. App. 57, 58, 67.

lished an off-record, and therefore "secret" federal employee-wage lien or trust that appears to take priority over all other consensual, statutory, and judicial liens.

Moreover, the Sixth Circuit's construction of this important enforcement provision of a national statute is indefensible. The FLSA deals with wages and hours. It does not deal with lien priorities. Yet, the Sixth Circuit's construction of the FLSA necessarily will interfere with the operation of federal and state statutes specifically intended to govern lien priorities, including, for example, the Federal Tax Lien Act of 1966, the Packers & Stockyards Act, the Perishable Agricultural Commodities Act, and Article 9 of the Uniform Commercial Code.

1. The court of appeals recognized that its holding in these cases is in square conflict with the holdings of the Second Circuit and the Fourth Circuit, expressly refusing to follow those courts. App., *infra*, 7a-8a. On facts that are indistinguishable from those presented here, the Second Circuit rejected the first attempt by the Secretary of Labor to use § 15(a)(1) as a club to coerce a secured creditor to pay the wages of employees of its insolvent debtor. *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730, 733 (2d Cir. 1966). Powell Knitting was a sweater manufacturer. In the three weeks before it ceased operations, Powell Knitting failed to pay its employees. Meinhard Commercial Corporation, a commercial factor, had made loans to Powell Knitting of approximately $700,000, secured by Powell's inventory and equipment. When Meinhard foreclosed on its inventory collateral, the Secretary filed suit to enjoin Meinhard from selling the inventory in violation of § 15(a)(1) of the FLSA.

The Second Circuit held § 15 inapplicable to a secured creditor in such circumstances. The court recognized that the "only reason" for invoking § 15 to prevent a secured creditor from disposing of its collateral would be to force the creditor to pay employee wage claims, and that such



a use of § 15 was no more than a "backhanded way" of subordinating the creditor's secured claims. 360 F.2d at 733. There was no evidence Congress had ever even considered such a use of the Fair Labor Standards Act. The Second Circuit therefore rejected the Secretary's assertion that Congress intended to force a secured creditor "to pay the wage earners to avoid § 15." *Id.*

The Fourth Circuit agrees with the Second. *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971). Thus, if the Ely inventory had been located in any of the states comprising the Second Circuit and the Fourth Circuit, Citicorp would have been free to sell its collateral, without paying the wages of Ely's employees.

2. The question presented is important to government lenders and private commercial lenders throughout the country. Moreover, its importance is bound to increase. Now that a court of appeals has upheld the Secretary's authority to enforce the "hot goods" provision against secured creditors, it is fair to assume the Secretary will not confine his use of this new power to states comprising the Sixth Circuit, but will press for adoption of the new rule in other circuits as well. See page 21, note 36, *infra*.

As Professor Gilmore has commented: "It is an observable fact of business life that a doomed enterprise, during the last few months before the final descent into 'hopeless insolvency,' typically succeeds in piling up a large amount of unsecured debt." 1 G. Gilmore, *Security Interests in Personal Property* 259 (1965).[10] Since employees usually are not paid in advance, some part of the unsecured debt of most defunct employers will be payroll. See, *e.g.*, *Donovan* v. *Agnew*, 712 F.2d 1509 (1st Cir. 1983). If, as the Sixth Circuit held, the FLSA establishes, in effect, a federal lien on all goods "pro-

[10] In 1984, approximately 52,000 businesses failed, with outstanding liabilities in excess of $29 billion. *See The Dun & Bradstreet Record of Business Closings* (March 12, 1986).

duced" by unpaid employees—a lien that takes priority over a previously perfected security interest—secured creditors of insolvent employers always will confront the risk of "secret" employee liens for unpaid wages superior to their security interests.[11] Until the Sixth Circuit's decision in these cases, it had been settled law that § 15(a)(1) did not apply to secured creditors or establish a federal lien or trust for employee-wage claims. The Sixth Circuit's contrary decision has introduced substantial uncertainty for both government and private secured creditors throughout the country.[12]

To accommodate their lending practices to the new priority rule, lending institutions must be able to determine whether the rule, however erroneous, has any application outside the Sixth Circuit. Uncertainty as to the interpretation of a national statute potentially affecting every secured financing arrangement throughout the country is intolerable. "In structuring financial transactions, businessmen depend on state commercial law to provide the stability essential for reliable evaluation of the risks involved." *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 739 (1979). Thus, it is particularly true in commercial finance that "it is more important that the applicable rule of law be settled than that it be settled

[11] Under § 3(j) of the FLSA, the term "produced" is broadly defined to mean "produced, manufactured, mined, handled, or in any other manner worked on in any State; and for the purposes of [the FLSA] an employee shall be deemed to have been engaged in the production of goods if such employee was employed in producing, manufacturing, mining, handling, transporting, or in any other manner working on such goods, or in any closely related process or occupation directly essential to the production thereof, in any State." 29 U.S.C. § 203(j). Thus, the federal wage-lien created by the Sixth Circuit extends to any goods "worked on" in any manner by any covered employee.

[12] Although federal law governs the priority of liens arising from federal lending programs, state law generally provides the rule of decision. *E.g., United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979).



right." [13] After nearly a half century, a settled construction of a national statute should be changed, if at all, only by Congress.[14]

The impact of the Sixth Circuit decision on both existing and prospective lending is fairly predictable. Particularly in labor-intensive industries, in which the normal outstanding payroll is a relatively larger percentage of unsecured debt, the rule adopted by the Sixth Circuit will tend to discourage secured lending and increase the costs to borrowers.[15] Having entered into financing arrangements on the basis of prior law, without any hint that the rule firmly established 20 years ago in *Powell Knitting* might be challenged, the national commercial financing community must reevaluate existing and prospective loans in light of the increased risks created by the Sixth Circuit's decision. Evaluation of the adequacy of security and therefore the availability of additional funding as well as determination of the appropriate interest rates are necessarily affected by this increased risk.

The impact of the Sixth Circuit's unprecedented construction of the FLSA on the intended operation of other federal statutes underscores the need for review. For,

[13] *Square D Co.* v. *Niagara Frontier Tariff Bureau, Inc.*, 106 S. Ct. 1922, 1931 (1986), quoting *Burnet* v. *Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting); *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 739-740 (1979); *see also United States* v. *Maine*, 420 U.S. 515, 528 n.9 (1975) ("the doctrine of *stare decisis* carries particular force where the effect of reexamination of a prior rule would be to overturn long-accepted commercial practice").

[14] *E.g., Square D Co.* v. *Niagara Frontier Tariff Bureau, Inc.*, 106 S. Ct. 1922, 1030-1931 (1986); *Herman & MacLean* v. *Huddleston*, 459 U.S. 375 (1983); *see Donovan* v. *Agnew*, 712 F.2d 1509, 1514 (1st Cir. 1983).

[15] *See generally* T. Jackson & A. Kronman, *Secured Financing and Priorities Among Creditors*, 88 Yale L.J. 1143, 1147-1149, 1163 (1979).

as this Court recently reiterated, "where . . . statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1018 (1984) (internal quotation marks omitted). In the Packers and Stockyards Act, Congress provided that "livestock purchased by a packer in cash sales, and all inventories of, or receivables or proceeds from meat . . . shall be held by such packer in trust for the benefit of all unpaid cash sellers of such livestock until full payment has been received by such unpaid sellers" (7 U.S.C. § 196(b)). Under the Sixth Circuit's interpretation of the FLSA, however, the unpaid livestock vendor could be enjoined from recovering and selling his cattle or the products thereof if the defaulting packer has failed to pay his employee, or, as in this case, has discontinued operations for financial reasons. Congress' specific intention under the Packers and Stockyards Act to protect sellers of cattle would thereby be frustrated. The same conflict would exist as to the trust for unpaid growers that Congress established in the Perishable Agricultural Commodities Act, 7 U.S.C. § 499e(c). Similarly, the lien that attaches to inventory pursuant to the Federal Tax Lien Act of 1966, 26 U.S.C. §§ 6321, *et seq.*, could be impaired if the taxpayer has failed to pay his employees. Further, because a federal tax lien is subordinate to the prior perfected security interest of a commercial lender, 26 U.S.C. § 6323(a), (c), the Sixth Circuit's construction of the FLSA may produce unintended and highly undesirable "circular priority" problems. See generally 2 G. Gilmore, *Security Interests in Personal Property* 1020-1046 (1965).[16]

[16] A federal tax lien is subordinate to the prior perfected security interest of a commercial lender, but the tax lien is superior to later unsecured employee-wage claims. The employee wage claims (according to the Sixth Circuit) would be superior to the senior security interest. Further, if this circularity of liens and claims existed when bankruptcy proceedings were initiated, the Sixth Circuit's rule would disrupt the Bankruptcy Code priority system, again contrary to Congress' clearly expressed intentions. *See generally* 3 *Collier on Bankruptcy* ¶ 507.03 (15th ed. 1986).



3. *a.* Traditionally, employee wage liens and the order of payment of creditors of insolvents have been governed by state law and federal bankruptcy law. These laws reflect the judgments of state legislatures and Congress as to the appropriate degree of protection to be afforded unpaid employees of financially distressed corporations. By contrast, the focus of the FLSA is minimum wage rates. It defies common sense to suggest that, in prescribing minimum wage and hour standards, Congress could have intended to displace otherwise controlling federal bankruptcy and state insolvency laws.

The Sixth Circuit's construction of § 15(a)(1) is not only wrong, but also inconsistent with Congress' policy of placing wage claims behind perfected security interests in bankruptcy and, outside the bankruptcy context, generally leaving creditors' rights and priorities to state legislation. As Judge Engel recognized, the majority effectively "create[d] a judicial lien" or secret trust for employee-wage claims, which is inconsistent with a substantial body of state law governing creditors' rights. When Congress has intended to supersede state law governing the priority of creditors' claims or to create off-record, "secret" trusts or liens to assure payment of particular creditors, it has done so explicitly, with due regard to the interests of both secured creditors and otherwise controlling state law.[17] Absent persuasive evidence

[17] *See Mahon* v. *Stowers*, 416 U.S. 100 (1974) (holding that Congress did not intend to establish a secret trust or lien to assure payment of cattlemen in the Packers & Stockyards Act, 7 U.S.C. § 181). In 1976, Congress amended the Packers & Stockyards Act to create a statutory trust on the proceeds of sale for unpaid cattlemen. 7 U.S.C. § 196. Similarly, in 1984 Congress explicitly created a statutory trust for the protection of vendors of certain agricultural commodities. Perishable Agricultural Commodities Act, 7 U.S.C. § 499e(c). *See also* Section 3466 Rev. Stat., 31 U.S.C. § 3713; Federal Tax Lien Act of 1966, 26 U.S.C. §§ 6321-6323.

that Congress intended to displace state law governing the priorities of creditors of insolvent corporations (not in bankruptcy), the general language of a federal statute should not be construed to have such an effect.[18]

Article 9 of the Uniform Commercial Code has been adopted by every state legislature in the country (except Louisiana), and by Congress for the District of Columbia.[19] Under Article 9 secured creditors generally are entitled to satisfaction of their claims out of property in which they have a perfected security interest before the property can be used to satisfy the claims of any general unsecured creditors, including, for example, employee-wage claims.[20] Further, notoriety by notice filing is critical to the operation of Article 9, and to the underlying concept that a potential creditor should be able to determine the risks and the priorities of other creditors before extending credit. See, *e.g.*, *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 739 n.42 (1979). Accordingly, with few exceptions, Article 9 avoids undisclosed and effectively undiscoverable "secret" liens or trusts that may defeat the claims of creditors with perfected security interests.[21]

Moreover, in addition to Article 9 of the Uniform Commercial Code, there is a wide variety of state legislation specifically governing employee-wage liens. Most of this legislation antedates the Fair Labor Standards Act, and Congress doubtless was aware of it. The statutes reflect the many and varied policy judgments that state legislators have made in dealing with the difficult problems of who should be preferred to whom when there is not enough money to pay all the debts of an insolvent. For example, while some states extend protection to virtually all employees, others limit protection to employees in particular industries.[22] Other states limit the dollar amount of the claims for which protection is provided; some

[18] *See, e.g., Louisiana Public Service Commission* v. *FCC*, 106 S. Ct. 1890, 1899 (1986) ("[t]he critical question in any pre-emption analysis is always whether Congress intended that federal regulation supersede state law"); *Philko Aviation, Inc.* v. *Shacket*, 462 U.S. 406, 409-411 & nn.2-4 (1983); *In the Matter of Gary Aircraft Corp.*, 681 F.2d 365, 368-372 (5th Cir. 1982), *cert. denied*, 462 U.S. 1131 (1983) (Wisdom, J.) (rejecting contention that Federal Aviation Act established federal priority scheme in the absence of "strong reasons to believe that Congress intended to displace" state law in this area). *See generally Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2121 & nn.32-33 (1986) (plurality opinion); *Garcia* v. *San Antonio Metropolitan Transit Authority*, 105 S. Ct. 1005, 1018 (1985); *Kirschbaum Co.* v. *Walling*, 316 U.S. 517, 520-522 (1942); H. Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 Colum. L. Rev. 543 (1954).

[19] *See United States* v. *Kimbell Foods, Inc.*, 400 U.S. 715, 732 n.28 (1979); *Slodov* v. *United States*, 436 U.S. 238, 257 n.22 (1978); *see generally* White & Summers, *Handbook of the Law Under the Uniform Commercial Code* 895 (2d ed. 1980).

[20] *See* Uniform Commercial Code, §§ 9-201, 9-301(1), 9-312, 9-501 to 9-507; *see generally* White & Summers, *Handbook on the Law Under the Uniform Commercial Code* 1030-1083 (2d ed. 1980). Secured creditors enjoy similar protection under the Federal Bankruptcy Code and its predecessor. *See generally 3 Collier on Bankruptcy* ¶¶ 506.02, 507.02, 507.03 (15th ed. 1986); 2 G. Gilmore, *Security Interests in Personal Property* 1051 (1965); *see also* *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730, 733 (2d Cir. 1966).

[21] Mechanic's liens or repairmen's liens, which may take priority over a perfected security interest under § 9-310, are not "secret" in the sense in which the term is used here, because such liens are effective against a perfected security interest only if the goods are in the "possession" of the vendor. *E.g., Forrest Cate Ford, Inc.* v. *Fryar*, 62 Tenn. App. 572, 577, 465 S.W.2d 882, 884 (1970); *see generally* Note, *The Priority Rules of Article Nine*, 62 Cornell L. Rev. 834, 907-918 (1977); Note, *Nonconsensual Liens Under Article 9*, 76 Yale L.J. 1649, 1656 & n.34 (1967).

[22] *Compare* Pa. Stat. Ann. tit. 43, § 221 (Purdon 1964) (virtually all employees) *with* Ala. Code § 35-11-90 (1977) (railroad employees); Me. Rev. Stat. Ann. tit. 10, §§ 3201-4012 (1980 & 1985 Supp.) (miscellaneous specific categories); Miss. Code Ann. § 85-7-1 (1985 Supp.) (agricultural employees).

impose no limitation.[23] Before Article 9 was adopted, some states arguably would have given priority to an employee-wage lien over a previously perfected security interest; others clearly did not.[24]

The holding of the Sixth Circuit, effectively establishing a federal lien or trust for employee-wage claims with priority over earlier perfected security interests and, presumably, other consensual, statutory, or judicial liens, thus nullifies contrary policy judgments of state legislatures throughout the country. Surely that was not Congress' intention when it enacted a wage and hour law.

*b.* Neither the language of § 15(a)(1) nor its purpose requires the creation of a "secret" employee-wage lien, superior to the claims of secured creditors and contrary to state law.[25] Moreover, the legislative history of the

[23] *Compare* Cal. Civ. Code § 3061.5 (Deering 1985 Supp.) (agricultural laborers, two weeks earnings, 25% of value of severed crops, or 25% of sale proceeds, whichever is less); Del. Code Ann. tit. 10, § 4931 (1975) (New Castle County, $50 and one month); Minn. Stat. Ann. § 514.59 (West 1986 Supp.) ($1000 or 5 weeks net wages up to $3000, whichever is greater) *with* Alaska Stat. § 34.35.435 (1985) (clerk, accountant, bookkeeper, *et al.*); Ind. Code § 32-8-24-1 (1986 Supp.)

[24] *Compare* Alaska Stat. § 34.35.435 (1985); Ark. Stat. Ann. § 51-320 (1971); S.C. Code Ann. § 29-11-10 (1977); Tenn. Code Ann. § 66-13-101 (1982) *with* Del. Code Ann. tit. 8, § 300 (1975); Fla. Stat. Ann. § 713.58 (1986 Supp.); Ind. Code § 32-8-24-2 (1986 Supp.); Ga. Code Ann. § 44-14-380 (1982); Minn. Stat. Ann. § 514.59 (West 1986 Supp.); *see DiAngelo* v. *McCormick Bros., Inc.*, 168 A. 79 (Del. Ch. 1933); *Flynn-Harris-Bullard Co.* v. *Johnson*, 90 Fla. 654, 107 So. 358 (1925).

[25] In the court of appeals, the Secretary argued that Congress' failure to enact a limited proposal authorizing the Department of Labor to grant exemptions from § 15(a)(1) supported the conclusion that the provision was intended to apply to secured creditors. Br. for the Secretary of Labor pp. 30-34. The Sixth Circuit correctly rejected the contention. App., *infra*, 10a-11a n.10. The only plausible inference to be drawn from the omission is that the exemption authority was deemed unnecessary. In any case where the



provision and common sense confirm that it was not intended to be used to force any bona fide purchaser, including a secured creditor, to pay the wages of the employees of an offending employer. The focus of the FLSA was the wage rates of ongoing businesses, not the consequences of the inability of an employer that has ceased operations to pay its employees. Section 15(a)(1) of the FLSA provides that it is "unlawful for any person to transport . . . ship, deliver, or sell in [interstate] commerce . . . any goods in the production of which any employee was employed" in violation of the minimum wage and overtime provisions of the Act. 29 U.S.C. § 215 (a)(1).[26] Consistent with the limits of the Commerce Clause, as understood in 1938, § 15(a)(1) was intended to establish a mechanism for enforcing the minimum wage and overtime standards of the FLSA against employers in the chain of production and distribution of goods in interstate commerce, unless specifically exempted.[27] Limited the reach of § 15(a)(1) to offend-

Secretary would have been authorized to grant an exemption, he could accomplish the same result by not seeking an injunction. *See also Weinberger* v. *Romero-Barcelo*, 456 U.S. 305, 313 (1982).

[26] When the FSLA was under consideration, there was substantial uncertainty as to whether this Court would sustain Commerce Clause legislation prescribing minimum wage, overtime, and child labor standards. *Compare Carter* v. *Carter Coal Co.*, 298 U.S. 238 (1936); *Schechter Poultry Co.* v. *United States*, 295 U.S. 495 (1935); *Hammer* v. *Dagenhart*, 247 U.S. 251 (1918), *with NLRB* v. *Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1937); *see also Fair Labor Standards Act of 1937, Joint Hearings Before the Senate Committee on Education and Labor and the House Committee on Labor on S. 2475 and H.R. 7200*, 75th Cong., 1st Sess. (*"1937 Joint Hearings"*) 1-89 (1937) (statement of Robert H. Jackson, Asst. Atty. Gen.).

[27] As then Assistant Attorney General Robert H. Jackson explained, the draftsmen of the FLSA had attempted "to consolidate in a single bill all hopeful approaches to constitutionality, each complete in itself, so that if one or more falls at the hands of the Courts, we will not be left for an interval while a new bill is being

ing employers, however, would have provided an obvious and ready means of circumvention.

Assistant Attorney General Robert Jackson's explanation in 1937 of the intended operation of the legislation makes it clear that if § 15(a)(1) had prohibited shipment or sale in interstate commerce only by the employers who violated the wage and hour provisions, "the law would be a nullity, because they could farm out the parts of the work that they wanted to do under substandard conditions." *1937 Joint Hearings* at 87.[28] The subcontractor would produce goods under substandard conditions and sell the goods only within a state to its principal, who would then incorporate the goods into a finished product for shipment or sale in interstate commerce. See *1937 Joint Hearings* at 85-87.[29] The prohibition against interstate shipment and sales would have been inapplicable to the subcontractor and, if the provision had been limited to prohibiting shipment or sale by only the offending employer, it would not have prevented the shipment of the finished product by the principal

adopted." *1937 Joint Hearings* at 2; *see id.* at 50-53, 85. Senate Bill 2475, § 7(a), one of the predecessors to § 15(a)(1) of the FLSA, was based on Mr. Justice Holmes' dissent in *Hammer* v. *Dagenhart*. *Id.* at 58. Thus, if a majority of this Court had accepted Justice Holmes' analysis and all other "approaches to constitutionality" failed, the minimum wage and overtime provisions could have been enforced solely through § 15(a)(1), by prohibiting shipment or sale in interstate commerce of goods produced under substandard conditions.

[28] The "sweatshop" was one of the evils Congress hoped to eliminate by passage of the FLSA. "By the sweatshop is ordinarily meant a subcontractor; that is, a contractor who takes work from a principal and takes it out to do under contract in a shop which may be in his home or may be in hired premises." *1937 Joint Hearings* at 196 (statement of Secretary of Labor Frances T. Perkins).

[29] *See also Rutherford Food Corp.* v. *McComb*, 331 U.S. 722 (1947) (rejecting contract labels in determining whether workers are "employees" or "independent contractors" for purposes of the FLSA).



either. See *id.* at 86. Thus, § 15(a)(1) prohibits "any person" from selling or shipping goods produced under substandard labor conditions, "and the fact that you change the title by selling them from A to B before they go into interstate commerce does not affect it." *1937 Joint Hearings* at 87.[30] That was the purpose of the "hot goods" provision; it was not intended to nullify state lien statutes by establishing a federal employee-wage lien.

The court of appeals' suggestion that enforcing § 15 (a)(1) against a secured creditor serves any Congressional purpose to protect competitors is untenable. App., *infra*, 6a-7a, 10a. The FLSA had one purpose: to improve the conditions under which Americans worked by raising wages and reducing hours.[31] Congress was concerned about competitors only to the extent that competition from "chiselers" had the effect of driving wages down. The reference to "competition" in Congress' findings and declaration of policy reflects the attempt to invoke every "hopeful approach to constitutionality" for prescription of wages, overtime, and child labor standards. See *1937 Joint Hearings* at 80, 85.[32] The court of

[30] *See, e.g., Hamlet Ice Co.* v. *Fleming*, 127 F.2d 165, 167 (4th Cir.), *cert. denied*, 317 U.S. 634 (1942) (rejecting intrastate seller's attempt to avoid FLSA).

[31] *United States* v. *Rosenwasser*, 323 U.S. 360, 361 (1945) (citation omitted); *see Rutherford Food Corp.* v. *McComb*, 331 U.S. 722, 727 (1947); *Donovan* v. *Agnew*, 712 F.2d 1509, 1517 (1st Cir. 1983).

[32] The basis for Congress' exercise of jurisdiction under the Commerce Clause was its finding that the existence of substandard "labor conditions" in industries "engaged in commerce or in the production of goods for commerce . . . (1) causes commerce and the channels and instrumentalities of commerce to be used to spread and perpetuate such labor conditions among the workers of the several States; (2) burdens commerce and the free flow of goods in commerce; (3) constitutes an unfair method of competition in commerce; (4) leads to labor disputes burdening and ob-

appeals thus confused the mechanism for enforcement and the jurisdictional basis of the FLSA with its purpose. Moreover, even if Congress was concerned about protecting business against competition from goods produced under substandard conditions, enforcing § 15(a)(1) against a secured creditor would not further that purpose. The debtor's costs of production are totally irrelevant to the foreclosing creditor, whose interest is to sell the goods at the best possible price, not to sell the goods cheaply to increase its market share and profits. Compare App., *infra*, 14a-15a.

The history of the FLSA before and after *Powell Knitting* confirms that it was never intended to affect the priority of perfected security interests in inventory of insolvent debtors. From 1938 to 1966, neither the Secretary of Labor nor anyone else read § 15(a)(1) to apply to secured creditors. See *Wirtz* v. *Powell Knitting*, 360 F.2d at 733.[33] In 1966, the Second Circuit rejected what appears to have been the first attempt to extend the reach of the Fair Labor Standards Act to secured creditors. The holding of the court of appeals in *Powell*

structing commerce and the free flow of goods in commerce; and (5) interferes with the orderly and fair marketing of goods in commerce." 29 U.S.C. § 202(a). *See, e.g., Maryland* v. *Wirtz*, 392 U.S. 183, 188-193 (1968); *United States* v. *Darby*, 312 U.S. 100, 109-110, 122 (1941).

[33] The 1949 amendment to § 15(a)(1) provides no support for the court of appeals' decision. *See* App., *infra*, 11a-12a. The amendment permits a good faith purchaser in the ordinary course of business to avoid any potential application of § 15(a)(1) by simply having the seller stamp or print on its invoice that its employees have been paid in accordance with the minimum wage and hour provisions. *See* 29 C.F.R. § 789.4 (1984). Congress thus confirmed what was manifestly implicit in the Act, as adopted in 1938, namely, that § 15(a)(1) was never intended to be invoked against innocent purchasers. There is no reason to believe that by expressly excluding the most obvious and common class of likely innocent purchasers, Congress thereby broadened the intended scope of § 15(a)(1).



*Knitting* remained settled law until the Sixth Circuit's decision in these cases.[34]

Thus, for almost 50 years it has been clear that the "hot goods" provision of the FLSA has no application to secured creditors. Congress is presumed to have been aware of the Second Circuit's holding in *Powell Knitting*.[35] Although the Fair Labor Standards Act has been amended several times since *Powell Knitting* was decided 20 years ago, Congress has not modified § 15(a)(1). Nor does it appear that the Secretary has sought legislation to overrule *Powell Knitting*.[36] Congress' failure to amend § 15(a)(1) is additional and persuasive evidence that the provision was never intended to establish a "secret" lien or trust for employee-wage claims, or to be used as a club to force a secured creditor to pay its debtor's employees.

[34] In 1971, the Fourth Circuit rejected another attempt by the Secretary to extend the reach of the Fair Labor Standards Act. *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971).

[35] *See Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2113 (1986) (plurality opinion); *Cannon* v. *University of Chicago*, 441 U.S. 677, 696-697 (1979).

[36] Instead, the Secretary filed these cases, in the words of Mr. J. Dean Speer, Department of Labor Area Director, because *Powell Knitting* "was a 1966 decision, [and] we needed to make some new law." C.A. App. 263.

## CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari to the Sixth Circuit should be granted.

Respectfully submitted,

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# APPENDIX

# APPENDIX

## UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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Nos. 85-5249 & 85-5252

WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
*Plaintiff-Appellee,*

v.

ELY GROUP, INC., ROCKFORD TEXTILE MILLS, INC.,
ELY & WALKER, INC.,
*Defendants,*

CITICORP INDUSTRIAL CREDIT, INC.,
*Defendant-Appellant.*

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On Appeal from the United States District Courts for the Eastern and Western Districts of Tennessee

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Decided and Filed April 23, 1986

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Before: ENGEL, KENNEDY and RYAN, Circuit Judges.

KENNEDY, Circuit Judge, delivered the opinion of the court, in which RYAN, Circuit Judge, joined. ENGEL, Circuit Judge, (pp. 13-16) delivered a separate dissenting opinion.

KENNEDY, Circuit Judge. These consolidated appeals present the question whether section 15(a)(1) of the Fair Labor Standards Act ("FLSA"), as amended, 29 U.S.C. § 215(a)(1), applies to holders of collateral obtained pursuant to perfected security interests. The United States District Courts for the Eastern and Western Districts of Tennessee held that the FLSA applies to secured creditors. For the reasons set forth below, we affirm.

On December 14, 1983, defendant-appellant, Citicorp Industrial Credit, Inc. ("Citicorp"), and Qualitex Corporation, an earlier name for a group of companies consisting of Ely Group, Inc. ("Ely Group") and its subsidiaries, Rockford Textile Mills, Inc. ("Rockford") and Ely & Walker, Inc. ("Ely & Walker"), (collectively "Ely"), signed a financing agreement. Under this "zero balance" [1] financing arrangement, Citicorp agreed, in its discretion, to loan up to $11,000,000 to provide the general working capital for Ely. As security for the loans, Ely granted Citicorp a security interest in inventory, accounts receivable, and various other assets. Citicorp filed financing statements and other appropriate documentation to perfect its security interests so that Citicrop undisputably qualifies as a perfected secured creditor.

In accordance with the financing agreement, Ely submitted various daily, weekly, and monthly reports to Citicorp. In the fall of 1984, Ely started missing sales projections. Accordingly, the loan balance considerably exceeded projections. In January 1985, Ely stopped sending reports to Citicorp. A Citicorp field examination determined that Ely's computerized accounting system was not functioning properly. By early February 1985, Ely's loan balance had increased to approximately $9,500,000. February 8, 1985 was the last day Citicorp advanced any funds to Ely. On February 11, 1985, Citicorp ceased funding Ely's operations. Ely's employees, however, continued working until February 19, 1985, when Citicorp foreclosed, taking possession of the collateral, and Ely ceased operations.

[1] Under a "zero balance" financing arrangement, the creditor transfers funds, on a daily or an "as needed" basis, into the debtor's "zero balance" bank account to meet the debtor's operating expenses. Accordingly, each day, after Ely's various banks informed Ely of the total amount of checks which had cleared, Ely personnel would notify Citicorp of the amount needed to cover those checks. Citicorp, in turn, would wire-transfer the necessary funds to Ely's bank accounts to fund Ely's disbursements, including payroll checks.



Since Ely defaulted on its payroll, its employees did not receive any wages for various workweeks, dating from January 27, 1985 to February 19, 1985. Consequently, the goods that Ely produced during this period were produced in violation of the FSLA's minimum wage and overtime provisions.[2] Acting on information that Citicorp planned to ship the goods in interstate commerce, the Department of Labor brought these actions to enjoin the shipment of the goods under 29 U.S.C. § 215(a)(1).

On March 15, 1985, Raymond J. Donovan, Secretary of Labor, United States Department of Labor,[3] filed a complaint and a motion for preliminary injunction and application for temporary restraining order in the United States District Court for the Eastern District of Tennessee, to enjoin Rockford, Ely Group, and Citicorp from placing goods allegedly produced in violation of the FLSA's minimum wage and overtime provisions in interstate commerce. The District Court denied the ap-

[2] FLSA § 6, codified at 29 U.S.C. § 206, requires employers to pay each employee minimum wages at the prescribed rate. FLSA § 7, codified at 29 U.S.C. § 207, requires employers to pay each employee one and one-half times the regular rate of pay for every hour in excess of forty hours that the employee works during a workweek.

[3] Pursuant to Fed. R. App. P. 43(c)(1), William E. Brock, Secretary of the United States Department of Labor, has replaced Raymond J. Donovan as a party in appeal No. 85-5249.

plication for a temporary restraining order on March 15, 1985. After hearing arguments, the District Court granted the motion for preliminary injunction on March 22, 1985. *Donovan v. Rockford Textile Mills, Inc.*, 608 F. Supp. 215 (E.D. Tenn. 1985). Citicorp filed a notice of appeal from that ruling, which the Clerk of this Court docketed as No. 85-5249. On April 10, 1985, the District Court granted Citicorp's motion for a stay or suspension of injunction pending appeal.

On March 21, 1985, Ford B. Ford, Under Secretary of Labor, United States Department of Labor,[4] filed a related complaint and motion for preliminary injunction and application for temporary restraining order in the United States District Court for the Western District of Tennessee against Ely Group, Rockford, Ely & Walker, and Citicorp. The District Court, following a telephone conference with counsel, granted the temporary restraining order on March 22, 1985. Following a hearing, the District Court granted the motion for a preliminary injunction on March 27, 1985. Citicorp filed a notice of appeal, which the Clerk of this Court docketed as No. 85-5252. On March 28, 1985, the District Court denied Citicorp's motion to stay or suspend the injunction. Citicorp immediately filed a motion for a stay pending appeal in this Court, agreeing to pay the unpaid employees the statutorily required wages in the event that this Court concluded that 29 U.S.C. § 215(a)(1) applies to Citicorp. This Court granted the requested stay on March 29, 1985.

Title 29 U.S.C. § 215(a)(1),[5] the FLSA's "hot goods" provision, prohibits "any person" from shipping, de-

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[4] In appeal No. 85-5252, William E. Brock has replaced Ford B. Ford as a party. *See supra* note 3.

[5] Title 29 U.S.C. § 215 provides in pertinent part:

> (a) After the expiration of one hundred and twenty days from June 25, 1938, it shall be unlawful for any person—



livering, or selling, in interstate commerce, goods that were produced in violation of FLSA's minimum wage and overtime provisions. Title 29 U.S.C. § 203(a) defines "person" as "an individual, partnership, association, corporation, business trust, legal representative, or any organized group of persons." Citicorp thus falls within the "plain meaning" of the statute. Citicorp, however, cites *Church of the Holy Trinity v. United States*, 143 U.S. 457 (1892), for the proposition that this Court should look beyond the plain meaning of the statute. In *Church of the Holy Trinity*, the Supreme Court stated:

> It is a familiar rule that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers.

*Id.* at 459. *See also United Steelworkers of America v. Weber*, 443 U.S. 193, 201, *reh'g denied*, 444 U.S. 889 (1979). Although courts may look behind the "plain

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> (1) to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 206 or section 207 of this title, or in violation of any regulation or order of the Administrator issued under section 214 of this title; except that no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful . . . .

meaning" of a statute when a literal construction would produce a nonsensical result or "'bring about an end completely at variance with the purpose of the statute,'" *id.* at 202 (quoting *United States v. Public Utilities Commission*, 345 U.S. 295, 315, *reh'g denied*, 345 U.S. 961 (1953)), we conclude that applying the "hot goods" provision to secured creditors, in fact, furthers one purpose of the FLSA, which is to keep goods that were produced in violation of the FLSA out of interstate commerce.

In *United States v. Darby*, 312 U.S. 100 (1941), the Supreme Court, after examining the declaration of policy in § 2(a) of the FLSA, codified at 29 U.S.C. § 202(a),[6] and the FLSA's legislative history, stated that the purpose of the FLSA

> is to exclude from interstate commerce goods produced for the commerce and to prevent their production for interstate commerce, under conditions detrimental to the maintenance of the minimum standards of living necessary for health and general well-being; *and* to prevent the use of interstate commerce as the means of competition in the distribution of goods so

[6] Title 29 U.S.C. § 202(a) provides:

> The Congress finds that the existence, in industries engaged in commerce or in the production of goods for commerce, of labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers (1) causes commerce and the channels and instrumentalities of commerce to be used to spread and perpetuate such labor conditions among the workers of the several States; (2) burdens commerce and the free flow of goods in commerce; (3) constitutes an unfair method of competition in commerce; (4) leads to labor disputes burdening and obstructing commerce and the free flow of goods in commerce; and (5) interferes with the orderly and fair marketing of goods in commerce. That Congress further finds that the employment of persons in domestic service in households affects commerce.



> produced, and as the means of spreading and perpetuating such substandard labor conditions among the workers of the several states.

*Id.* at 109-110 (emphasis added). While discussing § 15 (a)(1) of the FLSA, the Court stated:

> The motive and purpose of the present regulation are plainly to make effective the Congressional conception of public policy that interstate commerce should not be made the instrument of competition in the distribution of goods produced under substandard labor conditions, which competition is injurious to the commerce and to the states from and to which the commerce flows.

*Id.* at 115. *See also Roland Electric Co. v. Walling*, 326 U.S. 657, 667-69 (1946). Consequently, one of the reasons that Congress passed the FLSA was to exclude tainted goods from interstate commerce. Since Congress wanted to exclude goods that were produced in violation of the FLSA's minimum wage and overtime provisions from interstate commerce, prohibiting secured creditors, such as Citicorp, from shipping "hot goods" in interstate commerce furthers that Congressional intent. Accordingly, we follow the "plain language" of the statute and conclude that the phrase "any person" applies to Citicorp, as a secured creditor.[7]

In reaching this conclusion, we refuse to follow and reject the reasoning of the Second Circuit in *Wirtz v. Powell Knitting Mills Company, Inc.*, 360 F.2d 730 (2d

[7] We also note that in *Dunlop v. Carriage Carpet Co.*, 548 F.2d 139, 144 (6th Cir. 1977), while discussing the definition of the term "employee," this Court recognized that: "In interpreting provisions of the Fair Labor Standards Act the courts have construed the Act's definitions liberally to effectuate the broad policies and intentions of Congress." This Court stated that Congress used "key definitions of great breadth and generality" to accomplish its stated goals. *Id.* at 143.

Cir. 1966). In *Powell Knitting Mills*, the Second Circuit created a "judicial exception" to the FLSA by holding that FLSA § 15 did not prohibit a factor, which had foreclosed its lien on an insolvent manufacturer, from selling the manufacturer's sweaters in interstate commerce on the ground that the manufacturer had produced the sweaters in violation of FLSA's minimum wage provisions. In *Shultz v. Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971), the Fourth Circuit followed *Powell Knitting Mills* with little discussion but added an additional requirement "that there be no collusion between the manufacturer and his financier permitting the introduction into the market of goods produced in violation of the Act." *See also Dunlop v. Sportsmaster, Inc.*, 77 Lab. Cas. (CCH) ¶ 33,293 (E.D. Tenn. 1975).

In *Powell Knitting Mills, supra*, the Secretary of Labor appealed from a district court order vacating a temporary restraining order that the district court had issued against a manufacturer of sweaters and the manufacturer's factor. The vacated order prohibited the factor from selling certain sweaters that the factor had acquired when it foreclosed its lien. The manufacturer had not paid eighty-six of its employees wages totaling $8,425 for the weeks ending February 18, February 25, and March 5, 1966. Beginning September 2, 1965, the factor had made approximately $700,000 in cash advances to the manufacturer, secured by liens on the manufacturer's inventory and equipment. The factor filed financing statements. On March 8, 1966, the manufacturer ceased operations and made an assignment for the benefit of creditors. The factor foreclosed and the Secretary of Labor brought the action to enjoin the sale of certain sweaters which had been produced during the time when the manufacturer had not paid wages.

The Second Circuit acknowledged that "[u]nder a literal, or, as Judge Zavatt called it, 'wooden' reading of the Act, the government would be entitled to an injunction." *Id.* at 732. The court of appeals recognized that one purpose of the FLSA's "hot goods" provision "was to prevent adverse competitive effects on those who comply with the Act." *Id.* at 733. The Second Circuit, however, stated that "[h]ere there can be no connection between the asserted violation and any effects on competition." *Id.* Although the court also recognized that another purpose of the "hot goods" provision was to assure that "wage earners would be paid," the court "[found] it hard to believe that Congress contemplated that the foreclosing creditor would have to pay the wage earners to avoid § 15." *Id.* The court observed that "restraining the sale in interstate commerce (until the wage claims were paid) comes close to giving such wage claims a priority over secured creditors contrary to the scheme of the Bankruptcy Act." *Id. See* 11 U.S.C. § 507. The court concluded:

> The purpose of forcing payment of wages should not apply to the creditor who advanced funds long before the default in wages, and who merely forecloses his lien, at least where the value of the goods acquired does not exceed the debt left unpaid.

*Id* Accordingly, the Second Circuit affirmed the district court order vacating the temporary restraining order.

Although we are reluctant to create an intercircuit conflict, we cannot agree with the Second Circuit's "judicially created exception."[8] The Second Circuit's reasoning con-

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[8] Although twenty years have elapsed since the Second Circuit's decision, we do not think that the "judicially created exception" has become so well-settled as to preclude this Court from reexamining the Second Circuit's reasoning. *Contra Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 n.10 (1983) (courts had consistently recognized an implied cause of action under Rule 10b-5 for more than thirty-five years). Even though the Fourth Circuit and the United States District Court for the Eastern District of Tennessee, until one of the cases on appeal, followed *Powell Knitting Mills*, the two District Courts below and the United States District Court

flicts with the Supreme Court's interpretation of the purposes of the FLSA in *United States v. Darby, supra.* Congress does not want "hot goods" to taint the channels of interstate commerce. Furthermore, the "hot goods" in this case will compete with goods produced in conformity with the FLSA's minimum wage and overtime provisions if Citicorp places the goods in interstate commerce. The FLSA protects manufacturers who comply with the minimum wage and overtime provisions by keeping "hot goods" out of interstate commerce.[9] Our holding does not change the priorities in bankruptcy. Citicorp "owns" the goods. The "hot goods" provision merely prevents Citicorp from shipping, delivering or selling the goods in interstate commerce. Finally, the equities of the situation balance somewhere between Citicorp and the employees. Although Citicorp provided the capital and the materials for the production of the goods, that does not dictate that Citicorp should receive the benefits of the employee's labor during the three weeks which they worked on the goods but were not paid.

Congress has created only two exceptions—one for common carriers and one for good faith purchasers—to the broad scope of 29 U.S.C. § 215(a)(1), which otherwise applies to "any person."[10] Citicorp definitely does not

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for the Western District of Kentucky have refused to follow the "judicially created exception." *See also Brock v. Kentucky Ridge Mining Co., Inc.*, No. 85-0180 0(M) (W.D. Ky. Oct. 11, 1985).

[9] The dissenting opinion correctly notes that Citicorp has already sold the goods in question on the condition that it place the proceeds in escrow pending final resolution of this controversy. The dissent claims that "[t]he practical effect of the majority's decision is not to remove any tainted goods from competition . . . ." Citicorp, however, has effectively removed the "taint" from the goods by agreeing to pay the statutorily required wages if this Court holds that 29 U.S.C. § 15(a)(1) applies to secured creditors.

[10] We note that the legislative history of the FLSA does not conclusively indicate whether Congress intended the "hot goods" provision to apply to secured creditors. Although the Senate Bill



qualify as a common carrier. Citicorp has not raised the issue whether it could qualify as a good faith purchaser. We do observe, however, that although the extension of credit might qualify as a "purchase," Citicorp does not

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contained a provision that would have allowed a Labor Standards Board to exempt goods from the prohibition against interstate shipment if every person having a "substantial proprietary interest" in the goods could satisfy the Board that they had no reason to believe that any substandard condition existed in the production of the goods, the provision appeared in a reparation section. *See* H. Rep. No. 2738, 75th Cong., 3d Sess. 20 (1938). The exemption accordingly required that every employer having a proprietary interest in the goods who failed to maintain the required wage or hour standard to provide for the payment of reparation. The Senate Bill contained a separate section prohibiting the shipment of goods produced under substandard labor conditions. *Id.* at 17. Another section in the Senate Bill contained an exception to the prohibition against the interstate shipment of "substandard goods" for common carriers. *Id.* at 20. The House Amendment also prohibited the shipment of "substandard goods" in interstate commerce but also contained an exception for common carriers in the regular course of business. *Id.* at 26. The Conference Agreement adopted a version that closely followed the corresponding section of the House Amendment. *Id.* at 33.

In the Fair Labor Standards Amendments of 1949, Congress added an exception for "good faith purchasers" of goods produced in violation of the FLSA. The Conference Report stated:

> This [exception] protects an innocent purchaser from an unwitting violation and also protects him from having goods which he has purchased in good faith ordered to be withheld from shipment in commerce by a "hot goods" injunction. An affirmative duty is imposed upon him to assure himself that the goods in question were produced in compliance with the act, and he must have secured written assurance to that effect from the producer of the goods. The requirement that he must have made the purchase in good faith is comparable to similar requirements imposed on purchasers in other fields of law, and is to be subjected to the test of what a reasonable, prudent man, acting with due diligence, would have done in the circumstances.

Conf. R. No. 1453, 81st Cong., 1st Sess., *reprinted in*, 1949 U.S. Code Cong. & Ad. News 2241, 2271.

qualify as a "good faith purchaser" because Citicorp did not rely "on written assurance from the producer that the goods were produced in compliance with the requirements of [the FLSA]."[11] 29 U.S.C. § 215(a)(1). We agree that Congress never directly considered the question whether the "hot goods" provision applies to secured creditors. Nevertheless, Citicorp should not be in a better position as a secured creditor, for which Congress has not created an exception than as a "good faith purchaser," for which Congress specifically added an exception. Consequently, we conclude that *Powell Knitting Mills* created an exception for secured creditors that Congress did not and has not deemed appropriate. We, therefore, reject the reasoning in *Powell Knitting Mills* and hold that 29 U.S.C. § 215(a)(1) applies to secured creditors.

Accordingly, we affirm the orders of the District Courts granting the preliminary injunctions enjoining Citicorp from placing the goods in interstate commerce.

[11] Although the predecessor of Ely warranted, in the financing agreement, that it would "[c]omply with all laws, statutes, regulations and ordinances of any governmental entity," that representation does not amount to written assurance "that the goods *were* produced in compliance with the requirements of [the FLSA]."



ENGEL, Circuit Judge, dissenting. I respectfully dissent. I would follow the lead of the Second Circuit in *Wirtz v. Powell Knitting Mills, Inc.*, 360 F.2d 730 (2nd Cir. 1966), and of the Fourth Circuit in *Schultz v. Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971), and reverse.

If we were writing upon a clean slate, the majority opinion, in adopting a literal interpretation of the Fair Labor Standards Act, would have considerable appeal for the term "any person" is indeed broad and has been carefully defined by Congress, as the majority opinion observes. Beyond that, there is little to be said for the construction here mandated.

The evils foreseen and sought to be corrected by the Congress in enacting the "hot goods" provisions to the FLSA were twofold. Congress sought to improve working conditions by eliminating the incentive to manufacture goods at substandard wages and substandard hours; Congress also sought to prevent the injurious effect on trade that resulted when such goods were placed in interstate commerce in competition against goods that were manufactured in compliance with the FLSA. *See United States v. Darby*, 312 U.S. 100, 109-10 (1941). To accomplish these goals, Congress took the profit and, hence, the incentive out of such practices by making it unlawful to place into interstate commerce goods that were manufactured in noncompliance with the minimum wage and hour provisions of the FLSA. This much is clear.

In my opinion, however, an employer's inability to pay wages at all due to insolvency was not the target of the Act, at least where, as here, the employer is not otherwise shown to have been in noncompliance with the minimum wage and hour requirements of the statute. The problem here does not seem to have been an employer's unwillingness to comply with the Act, but instead an inability to pay any wages at all due to financial distress. Charac-

terizing the government's literal reading of the Act as "wooden," the Second Circuit observed in a similar situation, and correctly in my opinion, that "[o]ne purpose of making the sale illegal was to prevent the adverse competitive effects on those who comply with the Act. Here there can be no connection between the asserted violation and any effects on competition." *Wirtz v. Powell Knitting Mills Co.*, 360 F.2d 730, 733 (2nd Cir. 1966). It is just as reasonable to assume that perhaps one reason for the company's difficulty was its own previous compliance with the Act in the face of noncompliance by its competitors. No one has suggested that Congress, in passing the Fair Labor Standards Act, was seeking to tighten up the credit risks of producers of goods who may have otherwise been producing them in compliance with law but found themselves in financial difficulties. While imposing such risks upon lenders, as here, might hasten the demise of an insolvent company and thus avoid some loss to the wage earners who could not be paid at the end, the advantage of protecting otherwise valid security interests might equally have given the company precious time in which to recover from its straitened circumstances and thus to have provided employment at lawful wages longer.

The practical effect of the majority's decision is not to remove any tainted goods from competition for, as happened here, almost always the result will be that the goods are sold, if not in foreclosure, then in bankruptcy, or by other attaching creditors.[1] As here, the goods will go out in the market, but whether they are sold for competitively destructive prices will not depend on the cost

[1] The record discloses that an agreement was made in the district court whereby the goods were in fact released on condition that Citicorp place the proceeds of the sale in a separate account pending final resolution of this matter. Citicorp was therefore free and expected to dispose of these goods and, thus, to introduce them into interstate commerce to compete against those goods that were presumably manufactured in compliance with the Act.



of their production but upon the manner of their sale in any event. The real effect of the majority's interpretation is simply to create a judicial lien superior to the otherwise lawful lien which Citicorp possessed in the goods. In my view, this kind of pressure is the only motivation in the government in its present construction of the Act. Had it intended to create a federal lien law, Congress no doubt could have done so, but it did not. State laws governing creditors' rights, state laws protecting employees from non-payment of wages and bankruptcy laws generally, provide a great deal of relief for the protection of employees of defunct and insolvent corporations. It seems to me that in this special area of concern, the operation of these more traditional sources of law was intended by Congress to be sufficient. It is my opinion, therefore, that under a common sense application of section (15) (a) (1), Congress was looking instead at application of the Act in the course of the ongoing production of goods and not at the situation obtaining here and in the like cases in the Second and Fourth Circuits.

Even were I to agree with the majority here, I would still be reluctant to depart from a construction of the Act which has been in effect in the Second Circuit for twenty years and in the Fourth Circuit for nearly fifteen years. The need for a uniform national construction of the Act is obvious. Adherence to the existing interpretation, while expressing disagreement with it, could highlight the dispute should certiorari be sought, but without in the meanwhile creating a conflict in the circuits. While I do not argue in favor of any new rule respecting standards for avoiding intercircuit conflicts, we cannot be unaware that the resolution of intercircuit conflicts places a heavy burden upon the limited resources of the Supreme Court.[2]

[2] *See generally* Burger, *The Time is Now for the Intercircuit Panel*, 71 A.B.A.J. 86 (1985); Burger, *Annual Report on the State of the Judiciary*, 69 A.B.A.J. 442 (1983); Carrington, *Crowded Dockets and the Courts of Appeals: The Threat to the Function of*

Until there is a resolution of the problem, I would prefer to accept the judgment of other circuits where they have uniformly held to one construction over a long period of time, at least where I do not have an abiding and serious disagreement with the construction already in effect.

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*Review and the National Law,* 82 Harv. L. Rev. 542, 596 (1969); *see also* Wallace, *Nature and Extent of Intercircuit Conflicts: A Solution Needed for a Mountain or a Molehill?* 71 Calif. L. Rev. 913 (1983).



UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

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No. 85-5249/5252

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WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
*Plaintiff-Appellee,*
v.

ELY GROUP, INC., ROCKFORD TEXTILE MILLS, INC.,
ELY & WALKER, INC.,
*Defendants,*
CITICORP INDUSTRIAL CREDIT, INC.,
*Defendant-Appellant.*

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[Filed April 23, 1986]

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Before: ENGEL, KENNEDY and RYAN, Circuit Judges.

JUDGMENT

ON APPEAL from the United States District Courts for the Eastern and Western Districts of Tennessee.

THIS CAUSE came on to be heard on the record from the said District Courts and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the judgments of the said District Courts in this case be and the same are hereby affirmed.

It is further ordered that Plaintiff-Appellee recover from Defendant-Appellant the costs on appeal, as itemized below, and that execution therefor issue out of said District Courts, if necessary.

ENTERED BY ORDER OF THE COURT

JOHN P. HEHMAN
Clerk

/s/ John P. Hehman
Clerk

Issued as Mandate: 5/15/86

Costs: $168.00

UNITED STATES DISTRICT COURT
W.D. TENNESSEE W.D.

No. 85-2276H

FORD B. FORD, UNDER SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
*Plaintiff*,

v.

ELY GROUP, INC., ROCKFORD TEXTILE MILLS, INC.,
ELY & WALKER, INC., and
CITICORP INDUSTRIAL CREDIT, INC.,
*Defendants.*

March 28, 1985

## ORDER GRANTING PRELIMINARY INJUNCTION

HORTON, District Judge.

On March 21, 1985, this Court entered a temporary restraining order, upon application of the Under Secretary of Labor, United States Department of Labor, enjoining the defendants, Ely Group, Inc., Rockford Textile Mills, Inc., Ely & Walker, Inc., and Citicorp Industrial Credit, Inc., from transferring, releasing, disposing of or attempting to dispose of, liquidating, divesting, moving, allowing the removal of or attempt to remove from defendants' establishment in Memphis, Tennessee, or elsewhere, any raw products, materials, supplies, partially completed goods, finished goods, fixtures, machinery or other goods (as defined by Section 3(i) of the FLSA) then on said premises or elsewhere, and from disposing of or attempting to dispose of any other assets pending



a hearing on plaintiff's application for a preliminary injunction.

The Court conducted a hearing for a preliminary injunction, upon notice, on March 26, 1985, as specified in the temporary restraining order.

After a full hearing, the Court finds the following facts:

1) Ely Group Inc., a corporation doing business in Memphis, Tennessee, has been engaged in the manufacture, warehousing and distribution of hosiery, apparel, and other textiles and goods through its subsidiaries Rockford Textiles, Inc., and Ely & Walker, Inc.

2) Citicorp Industrial Credit, Inc. (Citicorp) has been engaged in the business of funding the operational needs of Ely Group, Inc. and its subsidiaries, pursuant to a Financing Agreement, as amended, dated December 14, 1983 (Ex. 2).

3) Citicorp funded on a daily basis a zero balance bank account for Ely Group, Inc. Ely Group, Inc., (Ely) was requested to notify Citicorp each day as they obtained information from the banks that checks had cleared and Citicorp transferred funds by wire daily to meet the banking needs of Ely Group, Inc. Payments by customers of Ely Group, Inc., were made to Citicorp through a lock box system, a control system insuring that the money owed by Ely Group would flow back to the creditor Citicorp. While there is no evidence of collusion between officials of Citicorp and Ely Group, Inc., the evidence does show that Citicorp knew it was funding the payroll of Ely Group, Inc., and when this funding ceased Ely could not meet its payroll obligations to its employees.

4) Citicorp perfected its security interest in all inventory, accounts receivable, and other assets of Ely Group, Inc. by filing for recordation all appropriate documents in the proper counties of Tennessee and with the Secre-

tary of State for the State of Tennessee. Citicorp is a secured creditor of Ely Group, Inc., and is fully perfected upon the assets of Ely Group, Inc., (Ex. 4).

5) Citicorp conducted an ongoing monitoring system through auditors and/or field examiners who verified collateral upon which it made cash advances to Ely Group, Inc. These representatives of Citicorp conducted this monitoring on the premises of Ely Group, Inc., and its subsidiaries. They checked inventory, sales, credits and purchases to see if they were consistent with figures supplied to it by Ely Group, Inc. While these representatives did not verify wages paid to employees, they did check to see if Ely Group, Inc. paid all employee taxes.

6) During the Fall of 1984, Ely Group, Inc., started missing its sales projections. In February of 1985, the loan balance was about $9,500,000 and Ely Group, Inc., was losing money. Citicorp was concerned with why the inventory of Ely Group, Inc., was dropping precipitously while no sales were occurring.

7) On February 8, 1985, Citicorp delivered a letter to Ely Group, Inc., informing Ely it would no longer make cash advances and all loans due Citicorp by Ely Group, Inc., were due and payable.

8 )On February 11, 1985, Ely Group, Inc., requested time to consult with a crisis management firm. This approach to the problems of Ely Group, Inc., did not prove worthwhile. Ely Group, Inc., was not generating cash but was actually consuming cash at the rate of $500,000.00 per week.

9) On February 19, 1985, Citicorp took possession of all assets of Ely Group, Inc., and the company ceased doing business on that date. Citicorp claims it is in a deficit position of $1,500,000 and is paying for warehousing of inventory it seized, guard service, insurance and utility bills. Citicorp has collected $1,200,000 in receivables at the Memphis location.



10) Hourly, bi-weekly and monthly employees have not been paid for their work which went into the manufacture and production of goods seized by Citicorp.

11) Approximately 300 hourly pay and bi-weekly pay employees at the Paragould, Arkansas, plant have not been paid for their work for a period of two to three weeks. Approximately 300 employees at the Rockford Textile Mills plants have not been paid for their work. In addition hourly, bi-weekly, monthly pay and executive employees who worked in the Memphis offices and warehouse remain unpaid.

12) While Citicorp argued that the entry of a preliminary injunction in this case will affect employment opportunities for Memphis workers at Ely Group, Inc., the evidence shows no future employment opportunities are contemplated for the Memphis operations of Ely Group, Inc. Instead, the proof shows Citicorp has negotiated a possible sale of a major part of the assets of Ely Group, Inc., and for plans to transfer inventory it has foreclosed upon from the Memphis warehouse facilities to Nashville, Tennessee and that transfer is imminent.

13) Representatives of the United States Department of Labor informed an attorney for Citicorp that goods had been produced by employees of Ely Group, Inc., and its subsidiaries, in violation of the Fair Labor Standards Act. Specifically, the Labor Department took the position these employees had not been paid according to the Act and the goods manufactured and produced during the period when employees were not paid could not be introduced into interstate commerce. The evidence is that Citicorp has shipped goods in interstate commerce since the facilities and subsidiaries of Ely Group, Inc., ceased operations and did so with knowledge that employees of the various entities had not been paid. Specifically there have been shipments to Walmart and Sears Roebuck & Company stores since February 19, 1985, of 1800 dozen shirts valued in excess of $100,000 and 2000 dozen shirts valued at about $7.60 per shirt.

14) Citicorp released a news items from its New York offices stating the inventory it had foreclosed upon pursuant to its perfected security interest would be sold to recoup some of its losses in its dealings with Ely Group, Inc., and subsidiaries.

The central issue in this case as stated by Citicorp is whether Section 15(a)(1) of the Fair Labor Standards Act applies to a secured creditor in possession who is fully perfected with top lien rights under state law. Can that secured creditor be forced by the Fair Labor Standards Act to take a back seat to unpaid workers despite its secured status? Stated another way, the issue is whether Citicorp, a secured creditor, who has foreclosed upon the assets of its debtor, Ely Group, Inc. and its subsidiaries, and is in possession of those assets, a substantial part of which were produced by unpaid workers allegedly in violation of the Fair Labor Standards Act, can be enjoined pursuant to Section 217, Title 29, United States Code from violating Section 215, Title 29, United States Code.

This Court rules Citicorp is subject to be enjoined and the Court finds it should grant a preliminary injunction enjoining Citicorp from disposing of any assets in its possession which were manufactured or produced by employees of Ely Group, Inc., and is subsidiaries, or any receivable collected for the sale of goods manufactured, produced or processed during the time workers were unpaid in violation of the Fair Labor Standards Act (FLSA).

Citicorp relies upon *Wirtz v. Powell Knitting Mills Co.*, 360 F.2d 730 (2d Cir. 1966), *Schultz v. Factors, Inc.*, 65 CCH Lab.Cas. 32, 487 (4th Cir.1971), and *Dunlop v. Sports-Master, Inc.*, 77 Lab.Cas. 33, 293 (E.D.Tenn. 1975). These cases hold the "hot goods" provision of FLSA does not apply to a secured creditor in possession of the assets of a debtor resulting from default of payment of loans previously advanced.



The Under Secretary of Labor maintains these cases apply an exception to the Fair Labor Standards Act (FLSA) which is not consistent with that Act as interpreted by the Supreme Court of the United States. The position of the Department of Labor, as stated in its brief filed March 21, 1985, is as follows:

The so-called "hot goods" provision of the Fair Labor Standards Act, 29 U.S.C. § 201, *et seq.*, is contained in § 15(a)(1) of the Act, 29 U.S.C. § 215(a)(1):

> After the expiration of one hundred and twenty days from the date of enactment of this Act, it shall be unlawful for any person—
>
> (1) to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 6 or section 7, or in violation of any regulation or order of the Secretary of Labor issued under section 14; except that no provision of this Act shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this Act shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of the Act, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful.

The basic purpose of the § 15(a)(1) prohibition, as the Supreme Court pointed out in *United States v. Darby*,

312 U.S. 100, 109-110, 61 S.Ct. 451, 454-55, 85 L.Ed. 609, "is to exclude from interstate commerce" goods produced under substandard labor conditions, which would compete unfairly with goods produced by complying employers, and which in their total effect might force complying employers out of business (*id.*, at 122, 61 S.Ct. at 461). This "evil" is the same whether the goods are sold and shipped in commerce by the manufacturer or by a foreclosing creditor. It is also immaterial that the tainted or "hot goods" held by the creditor are limited to the quantity in being at the time of the foreclosure. Thus, as the Supreme Court also pointed out in *Darby*, *supra*, "competition by a small part may affect the whole and . . . the total effect of the competition of many small producers may be great." *Id.* at 123, 61 S.Ct. at 461. An action to enforce the § 15(a) (1) prohibition is brought, not to compel the foreclosing creditor to pay the statutory wages or to put pressure on the defaulting producer to pay such wages, but to keep tainted goods from entering the channels of interstate commerce in competition with goods produced under the Act's standards.

Moreover, if foreclosing creditors are free to ship and sell tainted goods across state lines, the temptation to overextend credit to marginal producers is strong, as is the likelihood that such producers will become unable to meet their payrolls. The reason for this is that finance companies and institutions stand to reap financial gain by keeping such producers in business. A holding by this Court that creditors may not ship and sell in interstate commerce goods produced in violation of the Act will not only protect complying manufacturers from the unfair competition of such tainted goods, but, we submit, it will also discourage the type of commercial financing which leads to minimum wage and overtime violations.

This Court agrees with the position taken by the Department of Labor.



Section 15(a) (1) provides only two exceptions:

> no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and . . . any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful.

The Court finds neither applicable in the present case.

Further this Court concurs in the opinion of the United States District Court, Eastern District of Tennessee, Winchester Division, filed March 22, 1985. In that opinion, Judge Thomas G. Hull stated:

"No exception was specifically made by Congress in 29 U.S.C. § 215(a) (1) for a foreclosing creditor, and this Court refuses to read such an exception into the Act.

Secured creditors such as Citicorp take their security subject to the laws of the land. If such creditors have a security interest in property which was produced in violation of the provisions of the Fair Labor Standards Act, they retain their security interest, however, that interest is subject to the provisions of the Act. The Fair Labor Standards Act was enacted for the benefit and protection of the laborers and for the benefit and protection of employers who comply with the Act. As previously noted, goods produced in violation of the Act would compete unfairly with goods produced by complying employers. The market should not be flooded with goods produced in violation of the Act. In this instance, both the employees and

the secured creditor are innocent parties, the culprit being the manufacturer. However, in light of the purposes of the Act, it would be an unjust and harsh result for the creditor to get the benefit of the labor of the employees during the period of time they produced goods and were not paid as provided by the Act; a benefit which the creditor would not have without the employees labor."

Based upon all the evidence in the entire record in this case, the Court finds Citicorp Industrial Credit, Inc., a secured creditor in possession, imminently plans to ship goods in interstate commerce which were produced by employees of Ely Group, Inc., and its subsidiaries, Rockford Textile Mills, Inc., and Ely & Walker, Inc., and/or others, which were produced in violation of the Fair Labor Standards Act, 29 U.S.C. § 206, as amended, and the movement of these goods will result in the immediate and irreparable injury or damage to plaintiff and the public interest in that such shipment and movement of goods will make use of the channels and instrumentalities of interstate commerce to spread and perpetuate an unfair method of competition and interfere with the orderly and fair marketing of goods in commerce.

Plaintiff's application for a Preliminary Injunction is hereby ORDERED granted. It is further

ORDERED that defendants, their officers, agents, servants, employees and all persons in active concert or participation with them and all other persons who receive actual notice of this order by personal service or otherwise be, and they hereby are, enjoined from transferring, releasing, disposing of or attempting to dispose of, liquidating, divesting, moving, allowing the removal of or attempt to remove from defendants' establishment in Memphis, Tennessee, or elsewhere, any raw products, materials, supplies, partially completed goods, finished goods, or other goods now on said premises or elsewhere, and from disposing of or attempting to dispose of any



other assets which were produced during the period of time when employees of Ely Group, Inc., and its subsidiaries, were not paid for their labor as required by the Fair Labor Standards Act, specifically February 3, 1985, through February 19, 1985. It is further

ORDERED that this injunction covers accounts receivable collected by defendant Citicorp, and or any other defendant, on any goods produced by Ely Group, Inc., and its subsidiaries, during the same period of time, February 3, 1985, through February 19, 1985.

This order granting Preliminary Injunction shall remain in effect pending further costs of this Court or until the final disposition of this case.

UNITED STATES DISTRICT COURT
E.D. TENNESSEE
WINCHESTER DIVISION

No. CIV-4-85-26

RAYMOND J. DONOVAN, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
*Plaintiff,*

v.

ROCKFORD TEXTILE MILLS, INC., a Corporation;
ELY GROUP, INC., a Corporation; and
CITICORP INDUSTRIAL CREDIT, INC., a Corporation,
*Defendants.*

March 22, 1985

## MEMORANDUM AND ORDER

HULL, District Judge.

On Friday, March 15, 1985, the plaintiff, Raymond J. Donovan, Secretary of Labor, United States Department of Labor, filed a motion for preliminary injunction and application for temporary restraining order, seeking, among other things, to enjoin the defendants, Rockford Textile Mills, Inc., Ely Group, Inc. and Citicorp Industrial Credit, Inc. (Citicorp), from violating certain sections of the Fair Labor Standards Act, specifically 29 U.S.C. §§ 206, 215(a)(1), and 215(a)(2). The Court denied the initial application for a temporary restraining order on March 15, 1985, and notified the parties that the Court would hold a show cause hearing on the mo-



tion for a preliminary injunction on March 20, 1985.[1] At the hearing on March 20, 1985, the Court granted a preliminary injunction in open court. This memorandum and order contains the Court's reasons for issuing the injunction and describes the acts sought to be restrained as required by Rule 65(d), Federal Rules of Civil Procedure.

It is undisputed that the defendant Ely Group, Inc. d/b/a Rockford Textile Mills, Inc. is a corporation having places of business and doing business in Warren County, Tennessee; that at all times pertinent hereto, it was engaged in the manufacture of hosiery at its manufacturing plant in McMinnville, Tennessee; and that it has been and is engaged in commerce or the production of goods for commerce within the meaning of 29 U.S.C. § 203(b) and (j). It is also undisputed that the defendant Citicorp is a secured creditor of co-defendant Ely Group, Inc. d/b/a Rockford Textile Mills, Inc., a defaulting debtor on funds advanced by Citicorp, which funds were secured by, among other things, Ely's inventory and accounts receivable. It was stipulated by the parties that Citicorp has a perfected security interest and has taken possession of the collateral. Also undisputed is the fact that Ely Group, Inc. d/b/a Rockford Textile Mills, Inc., has failed to meet three payrolls due to be paid their employees during the workweeks ending February 9, 16, and 23, 1985. Further, it is undisputed that operations at the McMinnville plant ceased on February 19, 1985, at which time employees were told to leave.

Title 29 U.S.C. § 206 requires that employers such as Ely Group, Inc. d/b/a Rockford Textile Mills, Inc., pay its employees an hourly wage of not less than $3.35 per hour. Since it is conceded by the parties that the employees at the McMinnville plant were not paid their wages during three (3) payroll weeks, it is clear that all

[1] Jurisdiction to hear this matter is conferred upon the Court by 29 U.S.C. 217.

hosiery manufactured during that time period (from February 3, 1985, through February 19, 1985) were produced in violation of the Fair Labor Standards Act.

Title 29 U.S.C. § 215(a) provides, in pertinent part, that:

> (a) . . . it shall be unlawful for any person (1) to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 206 or section 207 of this title, or in violation of any regulation or order of the Administrator issued under section 214 of this title; except that no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced on compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful; (2) to violate any of the provisions of section 206 or section 207 of this title, or any of the provisions of any regulation or order of the Administrator issued under section 214 of this title;
>
> . . . .

Title 29 U.S.C. § 217 accords the district court jurisdiction to issue orders restraining violations of 29 U.S.C. § 215.



The issue presented in this instance is whether Citicorp as a secured creditor in possession is subject to be enjoined pursuant to 29 U.S.C. § 217 from violating 29 U.S.C. § 215.

The defendant Citicorp urges the Court to adopt the rationale used by the Court of Appeals for the Second Circuit in *Wirtz v. Powell Knitting Mills Co.*, 360 F.2d 730 (2d Cir.1966) which held that the "hot goods" provision does not reach creditors foreclosing by valid process for nonpayment of funds previously advanced. This rationale was adopted by the Fourth Circuit in *Schultz v. Factors, Inc.*, 65 CCH Lab.Cas. 32, 487 (4th Cir.1971) with the proviso that there must be no evidence of "collusion between the manufacturer and his financier permitting the introduction into the market of goods produced in violation of the Act."[2] Apparently, there are no Supreme Court or Sixth Circuit cases on point with the instant case.

The plaintiff Secretary of Labor contends that 29 U.S.C. § 215(a) is intended by Congress as an absolute prohibition against the sale or shipment of "hot goods" by "any person", with only two exceptions: one for common carriers and one for innocent purchasers, as specifically provided under the Act. The Court agrees and thus does not address the issue of whether there was collusion between the defendants in this case.

One of the basic purposes of 29 U.S.C. § 215 is to exclude from interstate commerce goods produced under substandard labor conditions which would compete unfairly with goods produced by complying employers, and which in their total effect might force complying employers out of business. Title 29 U.S.C. § 215, as passed by Congress, specifically provides an exceptoin for common carriers in order "to prevent a case involving the constitutionality of the act from arising in a suit be-

[2] The rationale used in the *Powell* and *Factors* decisions was adopted by the district court in *Dunlop v. Sportsmaster, Inc.*, 77 Lab.Cas. 33, 293 (E.D.Tenn. 1975.)

tween a shipper and a common carrier, to which the Government was not a party, inasmuch as the common carrier has no interest in the issue of constitutionality, but only in its obligation to accept goods for transportation." (H.Rept. 2182, 75th Cong., 3d Session, 1938, p. 14). Under the original Act, all persons except carriers were subject to the prohibition in 29 U.S.C. § 215(a)(1). In 1949, however, Congress granted an exception for innocent purchasers who had no intent to deal in "hot goods." To invoke this exception, the purchaser has the affirmative duty to assure himself that the goods in question were produced in compliance with the Act. The purchaser must show that he acquired the goods (1) for value, (2) in good faith, (3) without notice of violations, and (4) after obtaining written assurances from the producer that the goods were produced in compliance with the Act's requirements.

No exception was specifically made by Congress in 29 U.S.C. § 215(a)(1) for a foreclosing creditor, and this Court refuses to read such an exception into the Act.

Secured creditors such as Citicorp take their security subject to the laws of the land. If such creditors have a security interest in property which was produced in violation of the provisions of the Fair Labor Standards Act, they retain their security interest, however, that interest is subject to the provisions of the Act. The Fair Labor Standards Act was enacted for the benefit and protection of the laborers and for the benefit and protection of employers who comply with the Act. As previously noted, goods produced in violation of the Act would compete unfairly with goods produced by complying employers. The market should not be flooded with goods produced in violation of the Act. In this instance, both the employees and the secured creditor are innocent parties, the culprit being the manufacturer. However, in light of the purposes of the Act, it would be an unjust and harsh result for the creditor to get the benefit of the labor of the employees during the period of time they



produced goods and were not paid as provided by the Act; a benefit which the creditors would not have without the employees labor.

Upon consideration of the motion for a preliminary injunction filed herein, the supporting affidavits of Richard Corbin and Bob Woodward, and the stipulation of facts by the parties at the hearing, it appearing to the Court that there is reason to believe that shipments are being or are about to be made, by defendant Citicorp Industrial Credit, Inc., and/or others, of goods which were produced by employees of the defendants Ely Group, Inc., and Rockford Textile Mills, Inc., in violation of the Fair Labor Standards Act of 1938, 29 U.S.C. § 206, as amended, and since the movement of such goods in commerce will result in immediate and irreparable injury or damage to the plaintiff and the public interest, since such movemnent will make use of the channels and instrumentalities of commerce to perpetuate an unfair method of competition and interfere with the orderly and fair marketing of goods in commerce, it is

ORDERED that plaintiff's motion for a preliminary injunction be and the same hereby is granted, and it is further ORDERED that defendants, their officers, agents, servants, employees, all persons in active concert or participation with them and all other parties who receive actual notice of this order by personal service or otherwise be, and hereby are, enjoined from transferring, releasing, disposing of or attempting to dispose of, liquidating, divesting, removing, allowing the removal of, or attempt to remove from the premises of defendants' establishment in McMinnville, Tennessee, or elsewhere, any goods which were produced during the period of time from February 3, 1985, through February 19, 1985, in violation of 29 U.S.C. § 206, now on said premises or elsewhere and from disposing of or attempting to dispose of such goods.

This order shall remain in effect until final disposition of this case.

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

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Case No. 85-5252

WILLIAM E. BROCK, Secretary of Labor,
United States Department of Labor,
*Plaintiff-Appellee,*

v.

ELY GROUP, INC., ROCKFORD TEXTILE MILLS, INC.,
ELY & WALKER, INC.,
*Defendants,*

CITICORP INDUSTRIAL CREDIT, INC.,
*Defendant-Appellant.*

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[Filed Aug. 27, 1985]

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ORDER

On March 29, 1985, Defendant-Appellant Citicorp Industrial Credit, Inc. moved to stay the district court's Order of March 22, 1985, which order enjoined the Defendants herein from taking certain specified actions with respect to the goods, supplies and other assets of Defendant Ely Group, Inc., produced during the period February 3 through February 19, 1985.

The Court considered Citicorp's Motion, and granted it conditioned upon Citicorp's giving adequate security for the stay. Such security, proposed by Citicorp, consisted of placing all of the proceeds of sales of Ely's assets into a separate interest-bearing account.



On August 2, 1985, Citicorp moved to modify the Order of March 29 to provide that a balance of One Million Dollars ($1,000,000) be maintained in the designated account, which was opened in April, 1985.

The Court has considered Citicorp's Motion, and based upon it, the response filed by the Secretary, and the Hearing on this matter held August 21, 1985 and exhibits presented therein, hereby grants it with the proviso that One and One-Half Million Dollars ($1,500,000) be maintained in the account.

It is therefore ORDERED that this Court's Order of March 29, 1985, granting Citicorp's Motion for Stay Pending Appeal be modified to require that Citicorp maintain a balance of One and One-Half Million Dollars ($1,500,000) in a separate interest-bearing account, to remain in such account, along with accruing interest, pending further resolution of this matter, subject to the terms and conditions set forth in this Court's Order of March 29, 1985.

/s/ Robert B. Krupansky
ROBERT B. KRUPANSKY
Circuit Judge

### § 206. Minimum wage

Employees engaged in commerce; home workers in Puerto Rico and Virgin Islands; employees in American Samoa; seamen on American vessels; agricultural employees

(a) Every employer shall pay to each of his employees who in any workweek is engaged in commerce or in the production of goods for commerce, or is employed in an enterprise engaged in commerce or in the production of goods for commerce, wages at the following rates:

(1) not less than $2.65 an hour during the year beginning January 1, 1978, not less than $2.90 an hour during the year beginning January 1, 1979, not less than $3.10 an hour during the year beginning January 1, 1980, and not less than $3.35 an hour after December 31, 1980, except as otherwise provided in this section;

(2) if such employee is a home worker in Puerto Rico or the Virgin Islands, not less than the minimum piece rate prescribed by regulation or order; or, if no such minimum piece rate is in effect, any piece rate adopted by such employer which shall yield, to the proportion or class of employees prescribed by regulation or order, not less than the applicable minimum hourly wage rate. Such minimum piece rates or employer piece rates shall be commensurate with, and shall be paid in lieu of, the minimum hourly wage rate applicable under the provisions of this section. The Administrator, or his authorized representative, shall have power to make such regulations or orders as are necessary or appropriate to carry out any of the provisions of this paragraph, including the power without limiting the generality of the foregoing, to define any operation or occupation which is performed by such home work employees in Puerto Rico or the Virgin Islands; to establish minimum piece rates for any operation or occupation so de-



fined; to prescribe the method and procedure for ascertaining and promulgating minimum piece rates; to prescribe standards for employer piece rates, including the proportion or class of employees who shall receive not less than the minimum hourly wage rate; to define the term "home worker"; and to prescribe the conditions under which employers, agents, contractors, and subcontractors shall cause goods to be produced by home workers;

(3) if such employee is employed in American Samoa, in lieu of the rate or rates provided by this subsection or subsection (b) of this section, not less than the applicable rate established by the Secretary of Labor in accordance with recommendations of a special industry committee or committees which he shall appoint in the same manner and pursuant to the same provisions as are applicable to the special industry committees provided for Puerto Rico and the Virgin Islands by this chapter as amended from time to time. Each such committee shall have the same powers and duties and shall apply the same standards with respect to the application of the provisions of this chapter to employees employed in American Samoa as pertain to special industry committees established under section 205 of this title with respect to employees employed in Puerto Rico or the Virgin Islands. The minimum wage rate thus established shall not exceed the rate prescribed in paragraph (1) of this subsection;

(4) if such employee is employed as a seaman on an American vessel, not less than the rate which will provide to the employee, for the period covered by the wage payment, wages equal to compensation at the hourly rate prescribed by paragraph (1) of this subsection for all hours during such period when he was actually on duty (including periods aboard ship when

the employees was on watch or was, at the direction of a superior officer, performing work or standing by, but not including off-duty periods which are provided pursuant to the employment agreement) ; or

(5) if such employee is employed in agriculture, not less than the minimum wage rate in effect under paragraph (1) after December 31, 1977.

Additional applicability to employees pursuant to subsequent amendatory provisions

(b) Every employer shall pay to each of his employees (other than an employee to whom subsection (a) (5) of this section applies) who in any workweek is engaged in commerce or in the production of goods for commerce, or is employed in an enterprise engaged in commerce or in the production of goods for commerce, and who in such workweek is brought within the purview of this section by the amendment made to this chapter by the Fair Labor Standards Amendments of 1966, title IX of the Education Amendments of 1972, or the Fair Labor Standards Amendments of 1974, wages at the following rate: Effective after December 31, 1977, not less than the minimum wage rate in effect under subsection (a) (1) of this section.

Wage rates superseded by recommendation of special industry committee

(c) (1) The rate or rates provided by subsection (a) (1) of this section shall be superseded in the case of any employee in Puerto Rico or the Virgin Islands only for so long as and insofar as such employee is covered by a wage order (A) heretofore or hereafter issued by the Secretary pursuant to the recommendations of a special industry committee appointed pursuant to section 205 of this title, and (B) which prescribes a wage order rate which is less than the wage rate in effect under subsection (a) (1) of this section.



(2) (A) Each wage order rate under a wage order described in paragraph (1) which on December 31, 1977, is at least $2 an hour shall, except as provided in paragraph (3), be increased—

(i) effective January 1, 1978, by $0.25 an hour or by such greater amount as may be recommended by a special industry committee under section 208 of this title, and

(ii) effective January 1, 1979, and January 1 of each succeeding year, by $0.30 an hour or by such greater amount as may be so recommended by such a special industry committee.

(B) Each wage order rate under a wage order described in paragraph (1) which on December 31, 1977, is less than $2 an hour shall, except as provided in paragraph (3), be increased—

(i) effective January 1, 1978, by $0.20 an hour or by such greater amount as may be recommended by a special industry committee under section 208 of this title, and

(ii) effective January 1, 1979, and January 1 of each succeeding year—

(I) until such wage order rate is not less than $2.30 an hour, by $0.25 an hour or by such greater amount as may be so recommended by a special industry committee, and

(II) if such wage order rate is not less than $2.30 an hour, by $0.30 an hour or by such greater amount as may be so recommended by a special industry committee.

(C) In the case of any employee in agriculture who is covered by a wage order issued by the Secretary pursuant to the recommendations of a special industry committee appointed pursuant to section 205 of this title, to whom

the rate or rates prescribed by subsection (a)(5) of this section would otherwise apply, and whose hourly wage is increased above the wage rate prescribed by such wage order by a subsidy (or income supplement) paid, in whole or in part, by the government of Puerto Rico, the applicable increases prescribed by subparagraph (A) or (B) shall be applied to the sum of the wage rate in effect under such wage order and the amount by which the employee's hourly wage is increased by the subsidy (or income supplement) above the wage rate in effect under such wage order.

(3) If the wage rate of an employee is to be increased under this subsection to a wage rate which equals or is greater than the wage rate under subsection (a)(1) of this section which, but for paragraph (1) of this subsection, would be applicable to such employee, this subsection shall be inapplicable to such employee and the applicable rate under subsection (a)(1) of this section shall apply to such employee.

(4) Each minimum wage rate prescribed by or under paragraph (2) shall be in effect unless such minimum wage rate has been superseded by a wage order (issued by the Secretary pursuant to the recommendation of a special industry committee convened under section 208 of this title) fixing a higher minimum wage rate.

Prohibition of sex discrimination

(d)(1) No employer having employees subject to any provisions of this section shall discriminate, within any establishment in which such employees are employed, between employees on the basis of sex by paying wages to employees in such establishment at a rate less than the rate at which he pays wages to employees of the opposite sex in such establishment for equal work on jobs the performance of which requires equal skill, effort, and responsibility, and which are performed under similar working conditions, except where such payment is made



pursuant to (i) a seniority system; (ii) a merit system; (iii) a system which measures earnings by quantity or quality of production; or (iv) a differential based on any other factor other than sex: *Provided*, That an employer who is paying a wage rate differential in violation of this subsection shall not, in order to comply with the provisions of this subsection, reduce the wage rate of any employee.

(2) No labor organization, or its agents, representing employees of an employer having employees subject to any provisions of this section shall cause or attempt to cause such an employer to discriminate against an employee in violation of paragraph (1) of this subsection.

(3) For purposes of administration and enforcement, any amounts owing to any employee which have been withheld in violation of this subsection shall be deemed to be unpaid minimum wages or unpaid overtime compensation under this chapter.

(4) As used in this subsection, the term "labor organization" means any organization of any kind, or any agency or employee representation committee or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, rates of pay, hours of employment, or conditions of work.

Employees of employers providing contract services to United States

(e)(1) Notwithstanding the provisions of section 213 of this title (except subsections (a)(1) and (f) thereof), every employer providing any contract services (other than linen supply services) under a contract with the United States or any subcontract thereunder shall pay to each of his employees whose rate of pay is not governed by the Service Contract Act of 1965 or to whom subsection (a)(1) of this section is not applicable, wages at

rates not less than the rates provided for in subsection (b) of this section.

(2) Notwithstanding the provisions of section 213 of this title (except subsections (a)(1) and (f) thereof) and the provisions of the Service Contract Act of 1965, every employer in an establishment providing linen supply services to the United States under a contract with the United States or any subcontract thereunder shall pay to each of his employees in such establishment wages at rates not less than those prescribed in subsection (b) of this section, except that if more than 50 per centum of the gross annual dollar volume of sales made or business done by such establishment is derived from providing such linen supply services under any such contracts or subcontracts, such employer shall pay to each of his employees in such establishment wages at rates not less than those prescribed in subsection (a)(1) of this section.

Employees in domestic service

(f) Any employee—

(1) who in any workweek is employed in domestic service in a household shall be paid wages at a rate not less than the wage rate in effect under subsection (b) of this section unless such employee's compensation for such service would not because of section 209(g) of the Social Security Act constitute wages for the purposes of title II of such Act, or

(2) who in any workweek—

(A) is employed in domestic service in one or more households, and

(B) is so employed for more than 8 hours in the aggregate,

shall be paid wages for such employment in such workweek at a rate not less than the wage rate in effect under subsection (b) or this section.



§ 207. **Maximum hours**

(a) Employees engaged in interstate commerce; additional applicability to employees pursuant to subsequent amendatory provisions

(1) Except as otherwise provided in this section, no employer shall employ any of his employees who in any workweek is engaged in commerce or the production of goods for commerce, or is employed in an enterprise engaged in commerce or in the production of goods for commerce, for a workweek longer than forty hours unless such employee receives compensation for his employment in excess of the hours above specified at a rate not less than one and one-half times the regular rate at which he is employed.

(2) No employer shall employ any of his employees who in any workweek is engaged in commerce or in the production of goods for commerce, or is employed in an enterprise engaged in commerce or in the production of goods for commerce, and who in such workweek is brought within the purview of this subsection by the amendments made to this chapter by the Fair Labor Standards Amendments of 1966—

(A) for a workweek longer than forty-four hours during the first year from the effective date of the Fair Labor Standards Amendments of 1966,

(B) for a workweek longer than forty-two hours during the second year from such date, or

(C) for a workweek longer than forty hours after the expiration of the second year from such date,

unless such employee receives compensation for his employment in excess of the hours above specified at a rate not less than one and one-half times the regular rate at which he is employed.

(b) Employment pursuant to collective bargaining agreement; employment by independently owned and controlled local enterprise engaged in distribution of petroleum products

No employer shall be deemed to have violated subsection (a) of this section by employing any employee for a workweek in excess of that specified in such subsection without paying the compensation for overtime employment prescribed therein if such employee is so employed—

(1) in pursuance of an agreement, made as a result of collective bargaining by representatives of employees certified as bona fide by the National Labor Relations Board, which provides that no employee shall be employed more than one thousand and forty hours during any period of twenty-six consecutive weeks; or

(2) in pursuance of an agreement, made as a result of collective bargaining by representatives of employees certified as bona fide by the National Labor Relations Board, which provides that during a specified period of fifty-two consecutive weeks the employee shall be employed not more than two thousand two hundred and forty hours and shall be guaranteed not less than one thousand eight hundred and forty hours (or not less than forty-six weeks at the normal number of hours worked per week, but not less than thirty hours per week) and not more than two thousand and eighty hours of employment for which he shall receive compensation for all hours guaranteed or worked at rates not less than those applicable under the agreement to the work performed and for all hours in excess of the guaranty which are also in excess of the maximum workweek applicable to such employee under subsection (a) of this section or two thousand and eighty in such pe-



riod at rates not less than one and one-half times the regular rate at which he is employed; or

(3) by an independently owned and controlled local enterprise (including an enterprise with more than one bulk storage establishment) engaged in the wholesale or bulk distribution of petroleum products if—

(A) the annual gross volume of sales of such enterprise is less than $1,000,000 exclusive of excise taxes,

(B) more than 75 per centum of such enterprise's annual dollar volume of sales is made within the State in which such enterprise is located, and

(C) not more than 25 per centum of the annual dollar volume of sales of such enterprise is to customers who are engaged in the bulk distribution of such products for resale.

and such employee receives compensation for employment in excess of forty hours in any workweek at a rate not less than one and one-half times the minimum wage rate applicable to him under section 206 of this title,

and if such employee receives compensation for employment in excess of twelve hours in any workday, or for employment in excess of fifty-six hours in any workweek, as the case may be, at a rate not less than one and one-half times the regular rate at which he is employed.

(c), (d) Repealed. Pub.L. 93-259, § 19(e), Apr. 8, 1974, 88 Stat. 66.

(e) Definition of "regular rate" of employment

As used in this section the "regular rate" at which an employee is employed shall be deemed to include all

remuneration for employment paid to, or on behalf of, the employee, but shall not be deemed to include—

(1) sums paid as gifts; payments in the nature of gifts made at Christmas time or on other special occasions, as a reward for service, the amounts of which are not measured by or dependent on hours worked, production, or efficiency;

(2) payments made for occasional periods when no work is performed due to vacation, holiday, illness, failure of the employer to provide sufficient work, or other similar cause; reasonable payments for traveling expenses, or other expenses, incurred by an employee in the furtherance of his employer's interests and properly reimbursable by the employer, and other similar payments to an employee which are not made as compensation for his hours of employment;

(3) Sums paid in recognition of services performed during a given period if either, (a) both the fact that payment is to be made and the amount of the payment are determined at the sole discretion of the employer at or near the end of the period and not pursuant to any prior contract, agreement, or promise causing the employee to expect such payments regularly; or (b) the payments are made pursuant to a bona fide profit-sharing plan or trust or bona fide thrift or savings plan, meeting the requirements of the Administrator set forth in appropriate regulations which he shall issue, having due regard among other relevant factors, to the extent to which the amounts paid to the employee are determined without regard to hours of work, production, or efficiency; or (c) the payments are talent fees (as such talent fees are defined and delimited by regulations of the Administrator) paid to performers, including announcers, on radio and television programs;



(4) contributions irrevocably made by an employer to a trustee or third person pursuant to a bona fide plan for providing old-age retirement, life, accident, or health insurance or similar benefits for employees;

(5) extra compensation provided by a premium rate paid for certain hours worked by the employee in any day or workweek because such hours are hours worked in excess of eight in a day or in excess of the maximum workweek applicable to such employee under subsection (a) of this section or in excess of the employer's normal working hours or regular working hours, as the case may be;

(6) extra compensation provided by a premium rate paid for work by the employee on Saturdays, Sundays, holidays, or regular days of rest, or on the sixth or seventh day of the workweek, where such premium rate is not less than one and one-half times the rate established in good faith for like work performed in nonovertime hours on other days; or

(7) extra compensation provided by a premium rate to the employee, in pursuance of an applicable employment contract or collective-bargaining agreement, for work outside of the hours established in good faith by the contract or agreement as the basic, normal, or regular workday (not exceeding eight hours) or workweek (not exceeding the maximum workweek applicable to such employee under subsection (a) of this section,[1] where such premium rate is not less than one and one-half times the rate established in good faith by the contract or agreement for like work performed during such workday or workweek.

(f) Employment necessitating irregular hours of work

No employer shall be deemed to have violated subsection (a) of this section by employing any employee for

a workweek in excess of the maximum workweek applicable to such employee under subsection (a) of this section if such employee is employed pursuant to a bona fide individual contract, or pursuant to an agreement made as a result of collective bargaining by representatives of employees, if the duties of such employee necessitate irregular hours of work, and the contract or agreement (1) specifies a regular rate of pay of not less than the minimum hourly rate provided in subsection (a) or (b) of section 206 of this title (whichever may be applicable) and compensation at not less than one and one-half times such rate for all hours worked in excess of such maximum workweek, and (2) provides a weekly guaranty of pay for not more than sixty hours based on the rates so specified.

(g) Employment at piece rates

No employer shall be deemed to have violated subsection (a) of this section by employing any employee for a workweek in excess of the maximum workweek applicable to such employee under such subsection if, pursuant to an agreement or understanding arrived at between the employer and the employee before performance of the work, the amount paid to the employee for the number of hours worked by him in such workweek in excess of the maximum workweek applicable to such employee under such subsection—

(1) in the case of an employee employed at piece rates, is computed at piece rates not less than one and one-half times the bona fide piece rates applicable to the same work when performed during nonovertime hours; or

(2) in the case of an employee performing two or more kinds of work for which different hourly or piece rates have been established, is computed at rates not less than one and one-half times such bona



fide rates applicable to the same work when performed during nonovertime hours; or

(3) is computed at a rate not less than one and one-half times the rate established by such agreement or understanding as the basic rate to be used in computing overtime compensation thereunder: *Provided*, That the rate so established shall be authorized by regulation by the Administrator as being substantially equivalent to the average hourly earnings of the employee, exclusive of overtime premiums, in the particular work over a representative period of time;

and if (i) the employee's average hourly earnings for the workweek exclusive of payments described in paragraphs (1) through (7) of subsection (e) of this section are not less than the minimum hourly rate required by applicable law, and (ii) extra overtime compensation is properly computed and paid on other forms of additional pay required to be included in computing the regular rate.

(h) Extra compensation creditble toward overtime compensation

Extra compensation paid as described in paragraphs (5), (6), and (7) of subsection (e) of this section shall be creditable toward overtime compensation payable pursuant to this section.

(i) Employment by retail or service establishment

No employer shall be deemed to have violated subsection (a) of this section by employing any employee of a retail or service establishment for a workweek in excess of the applicable workweek specified therein, if (1) the regular rate of pay of such employee is in excess of one and one-half times the minimum hourly rate applicable to him under section 206 of this title, and (2) more than half his compensation for a representative period (not less than one month) represents commission on goods or serv-

ices. In determining the proportion of compensation representing commissions, all earnings resulting from the application of a bona fide commission rate shall be deemed commission on goods or services without regard to whether the computed commissions exceed the draw or guarantee.

(j) Employment in hospital or establishment engaged in care of sick, aged or mentally ill

No employer engaged in the operation of a hospital or an establishment which is an institution primarily engaged in the care of the sick, the aged, or the mentally ill or defective who reside on the premises shall be deemed to have violated subsection (a) of this section if, pursuant to an agreement or understanding arrived at between the employer and the employee before performance of the work, a work period of fourteen consecutive days is accepted in lieu of the workweek of seven consecutive days for purposes of overtime computation and if, for his employment in excess of eight hours and any workday and in excess of eighty hours in such fourteen-day period, the employee receives compensation at a rate not less than one and one-half times the regular rate at which he is employed.

(k) Employment by public agency engaged in fire protection or law enforcement activities

No public agency shall be deemed to have violated subsection (a) of this section with respect to the employment of any employee in fire protection activities or any employee in law enforcement activities (including security personnel in correctional institutions) if—

(1) in a work period of 28 consecutive days the employee receives for tours of duty which in the aggregate exceed the lesser of (A) 216 hours, or (B) the average number of hours (as determined by the Secretary pursuant to section 6(c)(3) of the Fair



Labor Standards Amendments of 1974) in tours of duty of employees engaged in such activities in work periods of 28 consecutive days in calendar year 1975; or

(2) in the case of such an employee to whom a work period of at least 7 but less than 28 days applies, in his work period the employee receives for tours of duty which in the aggregate exceed a number of hours which bears the same ratio to the number of consecutive days in his work period as 216 hours (or if lower, the number of hours referred to in clause (B) of paragraph (1) bears to 28 days,

compensation at a rate not less than one and one-half times the regular rate at which he is employed.

(*l*) Employment in domestic service in one or more households

No employer shall employ any employee in domestic service in one or more households for a workweek longer than forty hours unless such employee receives compensation for such employment in accordance with subsection (a) of this section.

(m) Employment in tobacco industry

For a period or periods of not more than fourteen workweeks in the aggregate in any calendar year, any employer may employ any employee for a workweek in excess of that specified in subsection (a) of this section without paying the compensation for overtime employment prescribed in such subsection, if such employee—

(1) is employed by such employer—

(A) to provide services (including stripping and grading) necessary and incidental to the sale at auction of green leaf tobacco of type 11, 12, 13, 14, 21, 22, 23, 24, 31, 35, 36, or 37 (as

such types are defined by the Secretary of Agriculture), or in auction sale, handling, stemming, redrying, packing, and storing of such tobacco,

(B) in auction sale, buying, handling, sorting, grading, packing, or storing green leaf tobacco of type 32 (as such type is defined by the Secretary of Agriculture), or

(C) in auction sale, buying, handling, stripping, sorting, grading, sizing, packing, or stemming prior to packing, of perishable cigar leaf tobacco of type 41, 42, 43, 44, 45, 46, 51, 52, 53, 54, 55, 61, or 62 (as such types are defined by the Secretary of Agriculture); and

(2) receives for—

(A) such employment by such employer which is in excess of ten hours in any workday, and

(B) such employment by such employer which is in excess of forty-eight hours in any workweek,

compensation at a rate not less than one and one-half times the regular rate at which he is employed.

An employer who receives an exemption under this subsection shall not be eligible for any other exemption under this section.

(n) Employment by street, suburban or interurban electric railway, or local trolley or motorbus carrier

In the case of an employee of an employer engaged in the business of operating a street, suburban or interurban electric railway, or local trolley or motorbus carrier (regardless of whether or not such railway or carrier is public or private or operated for profit or not for profit), in determining the hours of employment of such an employee to which the rate prescribed by subsection



(a) of this section applies there shall be excluded the hours such employee was employed in charter activities by such employer if (1) the employee's employment in such activities was pursuant to an agreement or understanding with his employer arrived at before engaging in such employment, and (2) if employment in such activities is not part of such employee's regular employment.

(*o*) Compensatory time

(1) Employees of a public agency which is a State, a political subdivision of a State, or an interstate governmental agency may receive, in accordance with this subsection and in lieu of overtime compensation, compensatory time off at a rate not less than one and one-half hours for each hour of employment for which overtime compensation is required by this section.

(2) A public agency may provide compensatory time under paragraph (1) only—

(A) pursuant to—

(i) applicable provisions of a collective bargaining agreement, memorandum of understanding, or any other agreement between the public agency and representatives of such employees; or

(ii) in the case of employees not covered by subclause (i), an agreement or understanding arrived at between the employer and employee before the performance of the work; and

(B) if the employee has not accrued compensatory time in excess of the limit applicable to the employee prescribed by paragraph (3).

In the case of employees described in clause (A)(ii) hired prior to April 15, 1986, the regular practice in effect on April 15, 1986, with respect to compensatory time off for such employees in lieu of the receipt of overtime com-

pensation, shall constitute an agreement or understanding under such clause (A)(ii). Except as provided in the previous sentence, the provision of compensatory time off to such employees for hours worked after April 14, 1986, shall be in accordance with this subsection.

(3)(A) If the work of an employee for which compensatory time may be provided included work in a public safety activity, an emergency response activity, or a seasonal activity, the employee engaged in such work may accrue not more than 480 hours of compensatory time for hours worked after April 15, 1986. Any such employee who, after April 15, 1986, has accrued 480 hours or 240 hours, as the case may be, of compensatory time off shall, for additional overtime hours of work, be paid overtime compensation.

(B) If compensation is paid to an employee for accrued compensatory time off, such compensation shall be paid at the regular rate earned by the employee at the time the employee receives such paymnt.

(4) An employee who has accrued compensatory time off authorized to be provided under paragraph (1) shall, upon termination of employment, be paid for the unused compensatory time at a rate of compensation not less than—

(A) the average regular rate received by such employee during the last 3 years of the employee's employment, or

(B) the final regular rate received by such employee, whichever is higher [2]

(5) An employee of a public agency which is a State, political subdivision of a State, or an interstate governmental agency—

(A) who has accrued compensatory time off authorized to be provided under paragraph (1), and



(B) who has requested the use of such compensatory time,

shall be permitted by the employee's employer to use such time within a reasonable period after making the request if the use of the compensatory time does not unduly disrupt the operations of the public agency.

(6) For purposes of this subsection—

(A) the term "overtime compensation" means the compensation required by subsection (a), and

(B) the terms "compensatory time" and compensatory time off" means hours during which an employee is not working, which are not counted as hours worked during the applicable workweek or other work period for purposes of overtime compensation, and for which the employee is compensated at the employee's regular rate.

(p) Special detail work for fire protection and law enforcement employees; occasional or sporadic employment; substitution

(1) If an individual who is employed by a State, political subdivision of a State, or an interstate governmental agency in fire protection or law enforcement activities (including activities of security personnel in correctional institutions) and who, solely at such individual's option, agrees to be employed on a special detail by a separate or independent employer in fire protection, law enforcement, or related activities, the hours such individual was employed by such separate and independent employer shall be excluded by the public agency employing such individual in the calculation of the hours for which the employee is entitled to overtime compensation under this section if the public agency—

(A) requires that its employees engaged in fire protection, law enforcement, or security activities be

hired by a separate and independent employer to perform the special detail,

(B) facilitates the employment of such employees by a separate and independent employer, or

(C) otherwise affects the condition of employment of such employees by a separate and independent employer.

(2) If an employee of a public agency which is a State, political subdivision of a State, or an interstate governmental agency undertakes, on an occasional or sporadic basis and solely at the employee's option, part-time employment for the public agency which is in a different capacity from any capacity in which the employee is regularly employed with the public agency, the hours such employee was employed in performing the different employment shall be excluded by the public agency in the calculation of the hours for which the employee is entitled to overtime compensation under this section.

(3) If an individual who is employed in any capacity by a public agency which is a State, political subdivision of a State, or an interstate governmental agency, agrees, with the approval of the public agency and solely at the option of such individual, to substitute during scheduled work hours for another individual who is employed by such agency in the same capacity, the hours such employee worked as a substitute shall be excluded by the public agency in the calculation of the hours for which the employee is entitled to overtime compensation under this section.